No. 76-1587

In the Supreme Court of the United States

OCTOBER TERM, 1976

FEDERAL POWER COMMISSION, PETITIONER

v.

SOUTHLAND ROYALTY COMPANY, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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No.

FEDERAL POWER COMMISSION, PETITIONER

v.

SOUTHLAND ROYALTY COMPANY, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Solicitor General, on behalf of the Federal Power Commission, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. A, *infra*, pp. 1a-11a) is reported at 543 F.2d 1134. The initial opinion and order (No. 737) of the Federal Power Commission (App. C, *infra*, pp. 14a-28a) and its

opinion and order (No. 737-A) denying rehearing (App. D, *infra*, pp. 29a-40a) are not officially reported.

JURISDICTION

The judgment of the court of appeals was entered on December 13, 1976 (App. B, *infra*, pp. 12a-13a). On March 3, 1977, Mr. Justice Powell extended the Commission's time for filing a petition for a writ of certiorari to and including May 12, 1977. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, as amended, 15 U.S.C. 717r(b).

QUESTION PRESENTED

Whether the lessors of land and their successors in interest, at the expiration of a 50-year lease, must obtain abandonment authorization from the Federal Power Commission under Section 7(b) of the Natural Gas Act before they may withdraw gas from interstate commerce after the lessee, during the lease term, had sold gas from the leaseholds in interstate commerce and had obtained from the Commission certificates of public convenience and necessity of unlimited duration authorizing that service.

STATUTES INVOLVED

Sections 1(b), 7(b), (c) and (e) of the Natural Gas Act, 52 Stat. 821, 824-825, as amended, 15 U.S.C. 717(b) and 717f(b), (c) and (e) are set forth in Appendix E, *infra*, pp. 41a-43a.

STATEMENT

On July 14, 1925, Gulf Oil Corporation (Gulf), then Gulf Production Company, executed an oil and gas lease with W. N. Waddell, *et al.* (Waddell Lease), under which Gulf obtained the exclusive right to explore, produce and market all oil and gas from 45,771 acres of land in Crane County, Texas (J.A. 135-140).[1] The lease provided that Gulf would also have "such other privileges as are reasonably requisite for the conduct of said operations" (J.A. 135), and that the lessors would receive a royalty based on the quantity of natural gas produced and the number of producing wells (J.A. 137). It further provided that the "lease shall not remain in force longer than fifty (50) years from this date * * *" (J.A. 136).

In 1951 and 1972, Gulf entered into contracts with El Paso Natural Gas Company (El Paso) for the sale of a quantity of "surplus residue gas"—that is, gas remaining after processing the gas attributable to the Waddell Lease (J.A. 40-66, 87-101).

After the decision of this Court in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, Gulf applied for and obtained certificates of public convenience and necessity of unlimited duration authorizing the service to El Paso, on May 28, 1956 (J.A. 23-40) and August 7, 1973 (J.A. 102-116).

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[1] "J.A." refers to the parties' Joint Appendix in the court of appeals.

On July 14, 1975, the Waddell Lease expired[2] and title to the mineral estate reverted to the reversionary mineral interest owners.[3]

On August 7, 1925, Gulf entered into a similar 50-year fixed term oil and gas lease with Goldsmith, *et al.* (Goldsmith Lease) under which Gulf obtained exclusive mineral rights to some 19,840 acres in Ector County, Texas (J.A. 293-297).[4] Gulf sold gas from the Goldsmith Lease to Phillips Petroleum Company (Phillips), which processed and sold the gas to El Paso at the outlet of Phillips' Goldsmith plant pursuant to certificates of public convenience and necessity granted by the Commission (16 FPC 1440). El Paso in turn transported the gas in interstate commerce for subsequent resale. The Goldsmith Lease expired on August 7, 1975, and title to the mineral estate reverted to the reversionary mineral interest owners.

In January 1975, El Paso petitioned the Commission to declare whether, when the Waddell Lease expired, the reversionary mineral interest owners (Southland, *et al.*) could cease deliveries to El Paso

[2] See *Gulf Oil Corporation* v. *Southland Royalty Company*, 496 S.W.2d 547 (Tex. Sup. Ct.).

[3] Prior to the expiration of the lease Southland Royalty Company (Southland) and more than 100 other companies and persons acquired fractional shares of the reversionary interest under the lease (see J.A. 149-165).

[4] On May 4, 1929, Texaco, Inc. (Texaco), then the Texas Gas Company, acquired a one-fourth (¼) interest in the reversionary mineral estate of the Goldsmith Lease (J.A. 297).

and sell the gas in intrastate commerce,[5] without prior abandonment authorization from the Commission pursuant to Section 7(b) of the Natural Gas Act, 15 U.S.C. 717f(b). Similarly, in April 1975, Texaco petitioned for a similar declaration with respect to gas produced from the reserves covered by the Goldsmith Lease. Because of the similarity of the issues presented, the Commission consolidated the proceedings (J.A. 362). Because there were no factual issues, no evidentiary hearings were sought or held (*ibid.*).

On July 11, 1975, the Commission issued Opinion No. 737 (App. C, *infra*, pp. 14a-28a) holding that Gulf and Phillips had dedicated the gas from the respective leases to interstate commerce pursuant to unlimited certificates of public convenience and necessity and that the reversionary mineral interest owners could not withdraw the gas from interstate commerce without prior abandonment authorization under Section 7(b). These findings were reaffirmed on rehearing in Opinion No. 737-A (App. D, *infra*, pp. 29a-40a).

On appeal, the court of appeals reversed the Commission's orders (App. A, *infra*, pp. 1a-11a). The court viewed the issue of interstate dedication as controlled by local law, noting that "[u]nder applicable Texas law, Gulf's rights were those of a tenant

[5] Shortly prior to the end of the lease period, Southland contracted with Intratex Gas Company, a non-jurisdictional gas pipeline in the state of Texas, for the sale of the gas which Gulf had not produced under the Waddell Lease.

for a term of years; its interest was a limited one which terminated completely when title reverted to Southland at the expiration of the 50-year term" (App. A, *infra*, p. 5a). Thus, "under well established concepts of property law, Gulf could not legally deal in or dedicate that portion of the gas which Southland might own upon termination of Gulf's estate" (App. A, *infra*, p. 6a). In sum, the court concluded that under principles of state property law the reversionary mineral owners were free to withdraw their gas from interstate commerce without Commission authorization.[6]

REASONS FOR GRANTING THE WRIT

The decision of the court of appeals presents an important issue respecting the Commission's authority under the Natural Gas Act. In holding that the present owners of natural gas reserves may abandon without Commission authorization a "service" in gas based on those reserves, commenced by their lessee and certificated by the Commission, the court has released billions of critically needed cubic feet of gas from their interstate commitment and seriously threatened the Commission's primary mandate to assure "maintenance of adequate service in the public interest."[7] The decision is contrary to the fundamental premise of the Act that, once gas is dedicated to interstate commerce by the issuance by the Commission of a certificate of public convenience and necessity, "there can be no withdrawal of that supply from continued interstate movement without Commission approval" regardless of intervening changes in property rights with respect to the gas. *Atlantic Refining Co.* v. *Public Service Commission of New York (CATCO)*, 360 U.S. 378, 389.

[6] Pending the final disposition of this case, the parties have entered into various agreements whereby the reversionary mineral owners are continuing to supply the gas in interstate commerce subject to the obligation of El Paso, in the event the decision below is sustained, to repay in kind gas delivered after termination of the leases.

The decision is further contrary to the construction by this Court of the abandonment provision of the Transportation Act of 1920, upon which Section 7(b) of the Natural Gas Act was modeled. It has long been established by decisions of the Interstate Commerce Commission (ICC) and this Court that the Transportation Act of 1920 requires approval of the ICC before certificated interstate service under a terminated railroad lease can be abandoned. In that context it has been recognized that to make the Commission's jurisdiction over rail service coterminous with railroad leases would enable parties to thwart the national interest in continued interstate service by conducting their business through short-term lease arrangements. The decision below poses the same threat to the nation's vital interest in the interstate supply of natural gas. Moreover, the court

[7] Section 7(c) of the Act, 52 Stat. 825. This language was later eliminated from the Act, without changing the Act's purpose. *Atlantic Refining Co.* v. *Public Service Commission of New York (CATCO)*, 360 U.S. 378, 388 and n. 7.

of appeals failed to recognize, as courts have recognized in the railroad context, that there is nothing unusual or inequitable in the imposition on lessors of the regulatory consequences of actions by their lessees that benefited the lessors and that were permitted and indeed required by the lease agreements.

1. The fundamental purpose of the Natural Gas Act is to assure an adequate and continued supply of natural gas to the nation at reasonable rates. See *Sunray Mid-Continent Oil Co.* v. *Federal Power Commission*, 364 U.S. 137, 147, 151-154; *CATCO*, *supra*, 360 U.S. at 388.[8] To implement that purpose, Section 7 of the Act provides that no natural gas company may commence, maintain or terminate an interstate service in natural gas without the permission and approval of the Commission. Thus, no natural gas company "shall engage in the transportation or sale of natural gas * * * unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations." Section 7(c), 15 U.S.C. 717f(c). Once an interstate service in natural gas is properly authorized and undertaken pursuant to a Commission certificate under Section 7(e), 15 U.S.C. 717f(e), it cannot be

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[8] As the court of appeals stated in *Sunray Mid-Continent Oil Co.* v. *Federal Power Commission*, 239 F. 2d 97, 101 (C.A. 10), reversed on other grounds, 353 U.S. 944:

> No single factor in the Commission's duty to protect the public can be more important to the public than the continuity of service furnished.

terminated without Commission authorization under Section 7(b), 15 U.S.C. 717f(b). The conditions under which abandonment may be authorized are set out in Section 7(b), which provides in part:

> No natural-gas company shall abandon * * * any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.[9]

The decision of the court of appeals is contrary to basic principles of Section 7 of the Act, reflected in this Court's decisions—particularly *Sunray Mid-Continent Oil Co.* v. *Federal Power Commission*, *supra*, and *Sun Oil Co.* v. *Federal Power Commission*, 364 U.S. 170. In those cases, the Court recognized that, in furtherance of the purposes of the Act, the primary focus of Section 7 is on the service of supplying gas to the interstate market, and not upon specific sales of gas, or the property interests or contract rights of individuals with respect to gas.

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[9] This Court in *CATCO*, *supra*, 360 U.S. at 389, described the interplay of these provisions as follows:

> Section 7(e) vests in the Commission control over the conditions under which gas may be initially dedicated to interstate use. Moreover, once so dedicated there can be no withdrawal of that supply from continued interstate movement without Commission approval.

In *Sunray, supra*, a producer of gas contracted to sell to an interstate pipeline a quantity of gas produced from its fields every year for twenty years, and applied to the Commission for a certificate authorizing the sale but providing for its own expiration at the end of the contract term. The Commission rejected the producer's application for a limited certificate and issued a certificate of unlimited duration. Reserving its right to object to the unlimited certificate on review, the producer commenced deliveries under the contract. On review, not only did this Court uphold the Commission's authority to issue an unlimited certificate, it expressly recognized that "[w]hen [the contract] expires, petitioner * * * will be under an obligation to continue to deliver gas to [the pipeline] on the latter's request unless it can justify an abandonment before the Commission * * *. The obligation that petitioner will be under after the contract term will not be one imposed by contract but by the Act." 364 U.S. at 155.

The Court based its decision on the significant distinction in Section 7 between specific sales of gas, and the "service" of supplying gas to interstate markets that the Commission's certificate authorized and required (364 U.S. at 149-151):

> [U]nder § 7(e) the Commission is authorized to issue a certificate authorizing the "service" covered by the application, as well as a "sale" * * *.
> * * * Thus, it is evident that all the matters for which a certificate is required * * * must be justified in terms of a "service" to which they

> relate. Accordingly, § 7(e) itself gives positive indication that the "service" which the Commission's certificate may authorize is something quite apart from simply the specific sales which § 7(c) forbids without a certificate sufficient to authorize them.

The Court also recognized that the Commission's power to authorize the service of supplying gas to interstate markets beyond the term of a contract and to require the continuation of that service notwithstanding changes in the parties' contractual rights to the gas is essential to the basic purposes of the Act. The Court noted that if the Commission's authority were limited to granting certificates covering only the duration of contracts, producers would be free by their contractual arrangements to cease interstate supply at their pleasure, to avoid the rate changing procedures of the Act, and even to threaten local communities with economic ruin. 360 U.S. at 142-143.[10]

In *Sun Oil, supra*, the Court applied the principles of *Sunray* to hold that the Commission's order issuing a large number of certificates (including the

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[10] As the Court observed (364 U.S. at 142):

> If petitioner's contentions * * * were to be sustained, the way would be clear for every independent producer of natural gas to seek certification only for the limited period of its initial contract with the transmission company, and thus automatically be free at a future date, untrammeled by Commission regulation, to reassess whether it desired to continue serving the interstate market.

Gulf certificate in this case)[11] were not limited to the contract period described in the applicant's application, but authorized and required the applicant to supply the service proposed in its application (*i.e.*, the sale of gas from the source designated in the application to the customer designated in the application) for an unlimited period. In short, *Sunray* and *Sun Oil* establish that once the service of supplying gas in interstate commerce has been authorized and has commenced,[12] " 'there can be no withdrawal of that supply from continued interstate movement without Commission approval' " (*Sunray*, *supra*, 364 U.S. at 156, quoting from *CATCO*, *supra*, 360 U.S. at 389), even though the supplier may have

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[11] The order granting Gulf's certificate (J.A. 23-40), which was before this Court in *Sun Oil* (see Transcript of Record, C.A. 5, No. 17,040, pp. 145-161), was an omnibus order granting more than 100 identical certificates of public convenience and necessity, the terms of which the Court set out at 364 U.S. at 172. Noting that "the certificate issued makes no reference to any limitation of time," the Court stated, "[W]e would hardly see any basis for overturning the Commission's view that no limitation as to time was implied" (364 U.S. at 175).

[12] It is settled that this commitment, once made, is binding on those who later come into possession of the mineral estate. As the court of appeals stated in *Hunt* v. *Federal Power Commission*, 306 F. 2d 334, 342 (C.A. 5), "[l]ike the ancient covenant running with the land, the duty to continue to deliver and sell flows with the gas from the moment of the first delivery down to the exhaustion of the reserve, or until the Commission, on appropriate terms, permits cessation of service under § 7(b) * * *" (citations omitted). See also *Mitchell Energy Corp.* v. *Federal Power Commission*, 533 F. 2d 258 (C.A. 5).

no contract obligation to deliver the gas and the customer no contract right to receive it and even though the supplier's application was with reference to a finite quantity of gas over time.[13]

Those principles apply full to this case. It is not disputed that Gulf properly undertook an interstate service in natural gas from its leaseholds and that that service was authorized by certificates from the Commission that contained no time limitation.[14] Gulf not only had the authority under its leases to develop and market the gas interstate but also had the reciprocal duty under the leases to do so,[15] since, as

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[13] The Commission may, of course, issue certificates limited to a specific period of time or limited to finite quantities of gas over time. *Federal Power Commission* v. *Moss*, 424 U.S. 494. But *Sunray* and *Sun Oil* establish that unless otherwise limited in the certificate, the service that a certificate authorizes is the supply of gas in the manner proposed in the application or in the contract referred to in the application, and that the service must continue until the source is exhausted or the Commission authorizes abandonment, even though the contract contemplated a finite term and thus the delivery of a finite quantity of gas.

[14] Because of a better developed record, the parties and the court of appeals focused their discussion on the Waddell Lease and subsequent transactions, rather than the Goldsmith Lease. Such differences as exist are immaterial to the issue presented, and that convention will be adopted here.

[15] A gas lease contains an implied covenant to develop and market the gas. *Weymouth* v. *Colorado Interstate Gas Co.*, 367 F. 2d 84 (C.A. 5). See also *Cole Petroleum Co.* v. *United States Gas & Oil Co.*, 41 S.W. 2d 414 (Tex. Sup. Ct); 5 Williams & Meyers, *Oil and Gas Law*, pp. 388 *et seq.* (1975). Thus, in view of the prevailing market conditions at the time, Gulf had an obligation under its leases to sell the gas to the interstate market.

this Court recognized in *CATCO, supra,* 360 U.S. at 394, at the time of its contracts with El Paso and Phillips, the interstate market was the principal available market for natural gas. Under the Act as construed in *Sunray* and *Sun Oil* that service must continue until the Commission permits its cessation even though the present suppliers, by virtue of the leases' termination, have no contract obligation to continue the supply.

For purposes of the Act, the fact that rights and interests have changed as a result of the expiration of a lease rather than a contract is immaterial.[16] The rationale and result of *Sunray* and *Sun Oil* would not have been different if the producers had undertaken to supply gas to interstate customers for a fixed term by means of lease arrangements rather than by sales contracts. The proposition that the expiration of leases terminates the obligation to continue certificated service would frustrate the purposes of the Act to the same extent and for the same reason as the contentions rejected in *Sunray* and *Sun Oil,* since producers and pipelines would be able to limit their service obligations under the Act, to evade rate regulation under the Act and to disrupt the interstate supply of gas by conducting business through short-term lease arrangements, or through leases terminable at will or upon specific conditions,

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[16] Indeed this court has recognized that the form of a transaction under state law does not control its federal regulatory consequences. *United Gas Co.* v. *Continental Oil Co.,* 381 U.S. 392.

such as rises in intrastate gas prices. In either the lease or contract situation, the obligation to continue certificated service is not "one imposed by [private agreement] but by the Act" (*Sunray, supra*, 364 U.S. at 155).[17]

2. The holding of the court of appeals that the reversioners may quit the interstate market without Commission authorization is contrary to this Court's construction of the parallel abandonment provisions of the Interstate Commerce Act. Section 7(b) of the Natural Gas Act was modeled upon Section 1(18) of the Interstate Commerce Act, 49 U.S.C. 1(18), which was added by Section 402 of the Transportation Act of 1920, 41 Stat. 477-478.[18] This Court had

[17] Similarly, the fact that the lessors may not have anticipated that the lessee's sales might subject the lessors to an obligation to continue interstate service is not controlling. In *Sun Oil*, for example, the petitioner did not anticipate when he signed a ten-year sales contract in 1947 that this Court in 1954 would interpret the Act as requiring him to obtain a certificate to sell his gas and that the certificate he obtained would require him to continue that service after the contract term. Moreover, as the courts have recognized in the context of railroad leases (see discussion at pp. 17-18, *infra*), the passage of the Natural Gas Act found the production and sale of natural gas under a variety of lease and contract arrangements and simply added regulatory conditions to the operation and termination of such arrangements. That such conditions may have been unanticipated does not lessen their force and effect.

[18] Section 7(b) of the Natural Gas Act originated as a proposed amendment to H.R. 11662, 74th Cong., 2d Sess. (1936), suggested by John E. Benton, General Solicitor, National Association of Railroad and Utility Commissioners. Hearing on H.R. 11662 before a Subcommittee of the House

held that railroad leases are subject to the Interstate Commerce Act's abandonment provisions (*Thompson* v. *Texas Mexican Railway Co.*, 328 U.S. 134, 144) and that "a certificate is required under § 1(18) whether the lessee or the lessor is abandoning operations" (*Smith* v. *Hoboken Railroad Co.*, 328 U.S. 123, 130).

Moreover, under the Interstate Commerce Act, the fact that the lease was entered into before the enactment of provisions requiring ICC approval for abandonment is immaterial; the obligation of a lessor under a railroad lease to continue service upon termination of the lease is an obligation imposed upon the leasehold by Congress in enacting supervening legislation. Thus in *Chicago & Alton Railroad Co.* v. *Toledo, Peoria & Western Railway Co.*, 146 ICC 171 (cited with approval by this Court in *Thompson* v. *Texas Mexican Railway Co.*, *supra*, 328 U.S. at 144), before the enactment of the abandonment provisions of the Interstate Commerce Act in 1920, the Chicago & Alton Railway leased from the Toledo, Peoria & Western Railway (Toledo) joint use of a certain portion of its track. The lease was terminable on twelve months' notice, and in 1927 the successor to Toledo gave such notice. The Chicago & Alton then filed a complaint with the ICC alleging that the pub-

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Committee on Interstate and Foreign Commerce, 74th Cong., 2d Sess., p. 98 (1936). Mr. Benton said of his proposal: "That language is largely taken from the abandonment provision of the Interstate Commerce Act" (*ibid.*). See, also, *Sunray Mid-Continent Oil Co.* v. *Federal Power Commission*, *supra*, 364 U.S. at 142 n. 9.

ic interest required continuance of its service. The ICC agreed despite the terms of the lease. Preliminarily, the Commission ruled that termination of operations under lease were within the abandonment provisions of its statute (146 ICC at 180-181):

> Although there is no express reference in these provisions to the * * * withdrawal of operations under lease, it seems clear that such * * * withdrawal is within the intended scope of the statute. The public interest in transportation lies primarily in the operation of railroads rather than in the facilities themselves. Operation under lease may comprise the entire operation of a line or any portion of any such operation, and the public interest therein is obvious, the extent varying with the circumstances. * * * In our opinion we have jurisdiction over the abandonment of the "operation" of a railroad under a trackage agreement * * *.

The Commission then addressed the contention that the lessor had a right to terminate the lease under local law (146 ICC at 181):

> It may be contended, however, that the parties have a legal right to rely upon the terms of their contract. Such a contention can not be sustained. The statute, upon its enactment, found railways in operation under various conditions, including, as in this case, operation under lease, by agreement between the owner and the user of facilities. The statute, in effect, added a new condition to the provisions for termination of such arrangements, namely, the condition that no abandonment of the operation in interstate or

> foreign commerce might occur without our approval.

Indeed, the ICC recognized the very danger, presented by this case, of manipulation of Commission jurisdiction by restructuring leases (*ibid.*):

> If our jurisdiction * * * [with respect to abandonment] is to be limited or circumscribed by the specific provisions of the contract [*i.e.*, railroad lease] and is only exercisable during the life of the contract as stated on its face, it could be entirely defeated by short-term contracts made renewable at the option of the parties.

See, also, *Chicago & North Western Railway Co.* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Co.*, 502 F.2d 193 (C.A. 7).

In an even more closely analogous case, the Commission refused to allow a lessor to abandon interstate rail service upon the expiration of his lessee's 50-year fixed term lease. The Commission reached this conclusion despite the lessor's claim that it was not within the Commission's jurisdiction because it had ceased to be an operating railroad *prior* to the passage of the Interstate Commerce Act in 1887. *Lehigh Valley Railroad Company Proposed Abandonment of Operation*, 202 ICC 659.

The principle of these cases is evident: The enactment by Congress of the Transportation Act of 1920 encumbered all railway operations undertaken under lease with the requirement that such service could not be abandoned without ICC authorization. Similarly, the enactment of the Natural Gas Act, as construed

by *Phillips*, imposed the requirement that no interstate service in natural gas based on leased reserves could be terminated without abandonment authorization from the Federal Power Commission under Section 7(b) of the Act.

3. The decision of the court below, in permitting lessors to terminate interstate services in natural gas without Commission authorization, would seriously undercut the Commission's ability to assure an adequate and reliable supply of natural gas. In immediate terms, the decision would free billions of cubic feet of natural gas reserves from their interstate dedication. Gulf has been selling interstate to El Paso approximately 25 million cubic feet per day of gas attributable to the Waddell Lease (J.A. 403) and 18 million cubic feet per day of gas attributable to the Goldsmith Lease (J.A. 409). In addition, continued dedication of the underlying reserves involved in numerous other fixed term leases which expired in 1976 is contingent upon this case.[19]

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[19] The following cases are pending in the Fifth Circuit awaiting the outcome of this case: *Dore Corp. and Sullivan-Wells Co.* v. *Federal Power Commission*, No. 76-2428; *Ft. Worth National Bank, et al.* v. *Federal Power Commission*, No. 76-2808; *Briercrest Oil Co.* v. *Federal Power Commission*, No. 76-2828 (all appeals of FPC orders dated March 12, 1976, March 24, 1976, and May 7, 1976). *Dore Corp. and Sullivan-Wells Co.* v. *Federal Power Commission*, No. 76-4093; *Briercrest Oil Co.* v. *Federal Power Commission*, No. 76-4169 (all appeals of FPC orders dated September 8, 1976 and October 27, 1976). *Ft. Worth National Bank, et al.* v. *Federal Power Commission*, No. 76-3785 (appeal of FPC orders dated July 6, 1976 and September 3, 1976).

Moreover, the proposition that the termination of a private lease agreement may automatically terminate the dedication of reserves is now being invoked in different contexts. Where gas from several leases had been dedicated to interstate service and gas from some leases had begun to flow in interstate commerce, but the other leases had been allowed to lapse, the lessors and subsequent lessees of the acreage have claimed that the dedication of reserves under the lapsed leases had automatically terminated. See *Northern Natural Gas Co.* v. *John L. Crawford*, Docket No. CS71-6 (issued September 29, 1976), appeal docketed *sub nom. Harrison* v. *Federal Power Commission*, C.A. 5, No. 76-4318, December 19, 1976.

In addition, lessors who have retained options to convert their royalty interests into working interests now claim that the dedication of the leasehold gas to interstate commerce by their lessees was ineffective to commit all the leasehold reserves to interstate commerce. *See Phillips Petroleum Co.*, Opinion No. 750, Docket No. CI76-68 (issued January 28, 1976), appeal docketed, C.A. 10, No. 76-1216, March 29, 1976, argued January 27, 1977. While each of those cases presents somewhat different facts, all involve the Commission's basic premise here—that once gas begins to flow in interstate commerce pursuant to a properly obtained Commission certificate, there may be no termination of service until the dedicated reserves are exhausted or the Commission authorizes abandonment.

4. Contrary to the court of appeals' apparent view, there is nothing inequitable about the Commission's position; and certainly not on the facts of this case. As noted, Gulf, as a mineral interest lessee, had an implied obligation to its lessors to develop and market the gas underlying the leaseholds in order to permit the lessors to earn their royalties (see note 15, *supra*, and accompanying text). Further, in the early 1950's the interstate market was the principal available market for such large quantities of gas (*CATCO*, *supra*, 360 U.S. at 394). Gulf therefore entered the interstate market in fulfillment of its lease obligations. As the Commission noted (App. D, *infra*, p. 34a n. 3), "the lease owners apparently had no objection to this interstate dedication, for they accepted royalties from such sales."[20] Having authorized and benefited from their lessee's interstate sales of leasehold gas, the reversionary mineral owners have no equitable basis for claiming that they should not be bound by the regulatory consequences of those sales.[21]

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[20] Accordingly, it is not unreasonable or inappropriate to assume that the reversionary mineral owners, had they been in possession at the time, would have made the same interstate sales.

[21] Indeed, under local law, even where one cotenant has made an improper oil and gas conveyance the other cotenant may ratify the conveyance by participating in the profits of the other cotenant's act. See *Woods* v. *Rolls*, 268 S.W. 988 (Tex. Civ. App.); *Texas & Pacific Coal & Oil Co.* v. *Kirtley*, 288 S.W. 619 (Tex. Civ. App.).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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MAY 1977.

APPENDIX A

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

Nos. 75-3373, 75-2851, 75-3682,
75-3819 and 75-4001

SOUTHLAND ROYALTY COMPANY et al., Texaco Inc., Exxon Corporation, and Mobil Oil Corporation, PETITIONERS

v.

FEDERAL POWER COMMISSION, RESPONDENT

Dec. 13, 1976

Petitions for Review of Orders of the Federal Power Commission (Texas Cases).

Before CLARK, RONEY and TJOFLAT, Circuit Judges.

CLARK, Circuit Judge:

Unprecedented escalations in the price of energy have stunned public, industry and engineers of federal regulatory process alike. The gross imbalance between controlled prices at which interstate natural gas must be sold [1] and the substantially higher values set by the free market for gas and other fuels has created a sunburst of unique regulatory issues. To-

[1] While this opinion was in preparation, the Federal Power Commission announced a dramatic increase in regulated natural gas prices which substantially eliminated this price gap.

day's case is one such ray. Southland Royalty Co., and others,[2] (Southland) challenge opinions of the Federal Power Commission (FPC) which held that natural gas which Southland now owns in fee under a leasehold reversionary interest had been dedicated to interstate commerce by the lessee of the property. The challenge presents this significant property rights vs. regulatory powers issue: Does the lessee under a 50-year fixed-term mineral lease, by making certificated sales of leasehold natural gas in interstate commerce, thereby dedicate to interstate commerce the gas which remains in the ground at the end of the 50th year? The FPC answered affirmatively. We reverse.

Two different leases are involved in the present case. Gulf Oil Corp. (Gulf) entered into a 50-year fixed-term lease on July 14, 1925, with W. N. Waddell. This lease covered approximately 46,000 acres in Crane County, Texas. Southland is the successor in title to the Waddell reversionary interest. After *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, 74 S.Ct. 794, 98 L.Ed. 1035 (1954), Gulf received a certificate of public convenience and necessity from the FPC which authorized the sale of surplus residue gas under its lease in interstate commerce to El Paso

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[2] Southland Royalty Company has ownership of approximately 47% of the acreage involved; trustees under the will of Warren Wright have 25.7%; Exxon Corporation, 14%; and more than 100 others own lesser shares.

Natural Gas Co. (El Paso).[3] A separate certificate was issued after Gulf and El Paso entered into a second contract in 1972 for the sale of further volumes of surplus residue gas. At no time was Southland a party to these contracts or the certification; the only interest which Southland held was the right to receive a royalty on the gas sold. Shortly prior to the end of Gulf's 50-year term, Southland contracted with the operator of an intrastate natural gas pipeline, Intratex Gas Company, for the future disposal of the gas covered by Southland's reversionary interest.

A similar 50-year fixed-term lease was executed August 7, 1925, between Gulf as lessee and Goldsmith and others as lessors. This lease covered approximately 20,000 acres in Ector County, Texas. In 1929 Texaco, Inc., acquired a one-fourth interest in the Goldsmith reversion. Southland also has a fractional interest in the reversion in the Ector County properties, as do other parties. The lessee, Gulf, made the same sort of unqualified interstate dedication of the natural gas being produced from this lease.

El Paso petitioned the FPC for a declaratory order establishing that Southland could not sell its gas in the intrastate market without first seeking FPC approval through abandonment procedures. 15 U.S.C. § 717f(b). Texaco also sought clarification of its po-

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[3] "Surplus residue gas," or casinghead gas, was the sole product sold by Gulf to El Paso. Gas-well gas from these properties was not dedicated to interstate commerce and has instead remained in the intrastate market.

sition with regard to the Ector County properties, and its petition was consolidated with that filed by El Paso.

The FPC held that the reversioners could not remove the gas from the interstate market without FPC approval to abandon. The principal basis for its conclusion was the unqualified dedication by the initial lessees of the properties committed all of the leasehold gas including that which might become the property of reversioners to the interstate market. Alternatively, the FPC asserted that the acceptance of royalties from interstate gas sales of the lessees constituted ratification by the reversioners.

The FPC reasoned that this provision of Section 7(b) of the Natural Gas Act:

> No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any *service rendered by* means of such facilities, without the *permission and approval of the Commission* first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permits such abandonment. [15 U.S.C. § 717f (b) (Emphasis supplied by the Commission.)]

and this language from the Supreme Court's opinion in *Atlantic Refining Co.* v. *Public Service Commission* [*CATCO*], 360 U.S. 378, 388-89, 79 S.Ct. 1246, 1253-54, 3 L.Ed.2d 1312 (1959):

> The [Natural Gas] Act was so framed as to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges. . . . Section 7(e) vests in the Commission control over the conditions under which gas may be initially dedicated to interstate use. Moreover, once so dedicated there can be no withdrawal of that supply from continued interstate movement without Commission approval.

authorized the conclusion that once the lessee had made a dedication of gas from the leasehold, none of the gas under those lands could be removed from the interstate market unless the FPC authorized abandonment. That Gulf's ownership was always limited to the gas produced within a fixed 50-year term was held to be irrelevant.

Under applicable Texas law, Gulf's rights were those of a tenant for a term of years; its interest was a limited one which terminated completely when title reverted to Southland at the expiration of the 50-year term. It is black letter law that a person holding a present interest in real property which is limited in duration cannot create an estate which will extend beyond the term of his interest. 2 R. Powell, The Law of Real Property ¶ 247[1] (Rohan Ed. 1967). *See also, e. g.*, 1 H. Tiffany, The Law of Real Property § 153 (3d ed. 1939); 2 H. Williams & C. Meyers, Oil & Gas Law § 332 (1975). Since Gulf never was possessed of rights in the gas under the leasehold lands which could survive the termination of its 50-year lease, it never could create rights in a

third person to that same gas. *Waddell* v. *Empire Drilling Co.*, 358 S.W.2d 221 (Tex. Civ. App.—Eastland 1962, writ ref'd n. r. e.). The estates in the single tract are as separate as though they subsisted in separate parcels of land. Though it is unquestioned that Gulf's dedication covered all of the surplus residue gas it produced during its lease term, there likewise can be no question that, under well established concepts of property law, Gulf could not legally deal in or dedicate that portion of the gas which Southland might own upon termination of Gulf's estate. Indeed, the FPC does not attack this construction of Texas law. Rather, it emphasizes that (1) the extent of Gulf's rights during its 50-year term was unquantified; (2) under its presently vested leasehold estate, Gulf had the right to withdraw all of the natural gas under the lease land if it could; and (3) the interest of the reversioners was both future and contingent. Under this state of affairs, FPC asserts that Gulf was empowered to dedicate all lease gas to the interstate market.

Though the FPC attempts to distinguish it, the conclusion reached in the case of *El Paso Natural Gas Co.* v. *Perry R. Bass*, 48 F.P.C. 1269 (1972), is a compelling argument for our decision here. Bass contracted with Shell Oil Company to develop the gas under his property, retaining, however, a royalty interest and an option to convert his royalty interest into a one-half working interest. Under the contract, Shell had no right to sell any gas attributable to Bass's working interest. Shell's operations were certificated

by the FPC for sales in interstate commerce to El Paso Natural Gas Company. Bass elected to convert his royalty to a working interest; El Paso sought a declaratory opinion from the FPC that Bass must proceed under the abandonment section of the Natural Gas Act as to his one-half working interest.[4] Responding to this contention, the FPC wrote:

> The thrust of El Paso's argument is that El Paso in some manner acquired a right to purchase that which Shell had no right to sell. We will not alter so the basic property rights of mineral interest owners through the fiction of Section 7(b) application. . . . El Paso's rights to purchase gas from . . . [the well] can rise no higher than Shell's rights to sell that gas. . . .

The alleged distinction between the *Bass* situation and the present case, namely, that Bass retained a present interest while here Southland had a future interest, is a distinction without a difference. In neither instance can a lessee encumber that which it does not own. To the extent that Gulf's present interest in all of the natural gas is contingent upon its removal within 50 years, the right to dedicate that gas removed to interstate commerce is likewise contingent. Whatever gas is left under the lease lands at the end of 50 years is not Gulf's gas and, by the plain terms of the limited leasehold estate, never belonged to it from day one forward.

The FPC's position could be apropos to a situation in which the subsequent holder of rights in the min-

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[4] 15 U.S.C. 717f(b).

erals has acquired or "succeeded" to those rights from a former holder who encumbered the estate. In general, when a successor comes into possession of the estate, he acquires it with all of the burdens on the property which were validly created by his predecessor in interest.[5] The contrary is true where the initial owner of property creates a limited estate in another subject to a provision that the remainder of the rights in the land will revert to the original owner upon the expiration of time. Such a conveyance creates no right to encumber or restrict the reversionary estate.[6] The FPC's failure to appreciate these basic distinctions in property law[7] is the genesis of its error.

The FPC also relied on *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137, 80 S.Ct. 1392, 4 L.Ed.2d 1623 (1960), in which the Supreme Court ruled that the request of Sunray for a limited 20-year certificate for sale in interstate commerce (based on Sunray's 20-year contract with the interstate pipeline company involved) did not restrict the FPC to issuance of such a limited certificate. The Court reasoned that when Sunray chose not to "avail itself of its undoubted

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[5] *Hartel* v. *Dishman*, 135 Tex. 600, 145 S.W.2d 865 (1940); *Stevenson* v. *Clausel*, 437 S.W.2d 404 (Tex.Civ.App.—Houston [14th Dist.] 1969, no writ).

[6] *First Nat. Bank* v. *Amarillo Nat. Bank*, 531 S.W.2d 905 (Tex.Civ.App.—Amarillo 1975); *Moore* v. *Kirgan*, 250 S.W. 2d 759 (Tex.Civ.App.—El Paso 1952, no writ).

[7] The Commission stated "[f]or the practical purposes of the Act it makes no difference whether the successors happen to be assignees, purchasers or reversionary interests." Opinion 737, July 11, 1975.

right to stand firm on its own application, and reject the proffered certificate," it waived its right to deny the certificate's validity. Id. at 141, 80 S.Ct. at 1395. The Court pointed out that the certificate of public convenience and necessity contemplated by the act is not intended to relate to any specific sale contemplated by the parties. Instead, it is based on the service to be rendered—the movement of natural gas in interstate commerce. Thus, the contract between the pipeline company and Sunray was merely the arrangement under which Sunray commenced its service.

The FPC's reliance upon *Sunray* as authority here is misplaced. The Court did not require Sunray to dedicate to interstate markets oil or gas which it did not own. It enforced the statutory scheme without impairing any contractual right since at the end of its initial 20-year sale contract period Sunray (or its successors in title) would still be the legal owner of the leasehold mineral estate. Indeed, the Court clearly indicated that it contemplated the continuation of ownership of the commodity which was dedicated by its reference to Sunray's ability to effectuate delivery of the service as a prerequisite to certification. On the other hand, Gulf, in the present case, at all times lacked the legal ability to deliver any gas from Southland's property after the expiration of its limited 50-year term.

The FPC further contends that since the application by Gulf for a certificate to sell in interstate commerce did not mention its limited interest, Southland cannot contend that its reversion is not subject to

FPC control. Under such a theory a present interest holder could bind his reversioner by taking actions that exceed the actor's rights. The FPC's position is that this invasion should be permitted and the reversioner "protected" by a cause of action in state court against the present interest holder for the wrong. The approach stands both logic and land law on their heads. It is fallacious to justify the creation of a wrong by demonstration that a remedy is possible. Under Texas law Gulf's 50-year lease interest did not authorize it to impose any limitation on the reversionary estate. Having no right, it equally lacked the power to encumber the reversion by actions in excess of those authorized by its grant.

We are not concerned in the present case with any possibility of apparent or implied authority. Gulf's lease was properly recorded on the public land records. Its 50-year term limitation was within the FPC's constructive, if not its actual, knowledge. The contention that a lack of information justified reliance by the FPC and the public that the dedication to interstate markets of this gas extended beyond the expiration of Gulf's lease term is an assertion supported by neither fact nor authority. Moreover, no mention of this contention before us was made in the FPC's opinion. *See, FPC* v. *Texaco, Inc.*, 417 U.S. 380, 397, 94 S.Ct. 2315, 2326, 41 L.Ed.2d 141 (1974). We reject this argument on both substantive and procedural grounds.

Alternatively, the FPC argues that Southland ratified Gulf's improper dedication of all leasehold gas

to interstate commerce by acceptance of royalty payments during the term of the leases. Ratification implies knowing choice.[8] By accepting royalties paid by Gulf during the term of its lease, the holders of the reversionary interest committed no action inconsistent with their reversionary rights. The sale of natural gas produced from the leaseholds within the lease term was solely Gulf's prerogative. The holders of the reversion could not control its exercise further than to require payment of the proper contract royalty. By accepting that royalty, the petitioners received only that to which they were entitled under their lease. As we have held above, under Texas property law Gulf could not bind the reversionary estate by its actions. Thus, lessors could not have known it would be claimed that Gulf's dedication of its gas affected their reversionary interest.

The decision of the Federal Power Commission is

REVERSED.

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[8] *Williams* v. *Thrasher*, 62 F.2d 944 (5th Cir. 1933); *Kunkel* v. *Kunkel*, 515 S.W.2d 941 (Tex.Civ.App.—Amarillo 1974, writ ref'd n. r. e.); *Yelderman* v. *McCarthy*, 474 S.W.2d 781 (Tex.Civ.App.—Houston [1st Dist.] 1971, writ ref'd n. r. e.).

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

October Term, 1975

No. 75-3373

Your No. FPC CP75-209

SOUTHLAND ROYALTY COMPANY, ET AL., PETITIONERS

versus

FEDERAL POWER COMMISSION, RESPONDENT

Petition for Review of an Order of the
Federal Power Commission (Texas Case)

Before CLARK, RONEY and TJOFLAT, Circuit Judges.

JUDGMENT

This cause came on to be heard on the petition of Southland Royalty Company, et al. for review of an order of the Federal Power Commission and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the petition for review of an order of the Federal Power Commission in this cause be, and the same is hereby reversed;

It is further ordered that respondent pay to petitioners, the costs on appeal to be taxed by the Clerk of this Court.

December 13, 1976

Issued as Mandate:

APPENDIX C

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Opinion No. 737

[SEAL]

Docket No. CP-75-209

EL PASO NATURAL GAS COMPANY

Docket No. CI75-594

TEXACO INC.

DECLARATORY OPINION AND ORDER ON TERMINATION OF LONG-TERM LEASES

Issued: July 11, 1975

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: John N Nassikas, Chairman; William L. Springer, and Don S. Smith.

Docket No. CP75-209

EL PASO NATURAL GAS COMPANY

Docket No. CI75-594

TEXACO INC.

Opinion No. 737

DECLARATORY OPINION AND ORDER ON TERMINATION OF LONG-TERM LEASES

(Issued July 11, 1975)

PER CURIAM.

El Paso Natural Gas Company on January 20, 1975, filed in Docket No. CP75-209 a petition for a declaratory order with respect to a 50-year fixed term lease currently held by Gulf Oil Corporation and others (Gulf, *et al.*) which will expire on July 14, 1975. By the terms of the lease Gulf obtained the exclusive right to produce and sell oil and gas from 45,771 acres of land in Crane County, Texas. When the lease expires, the mineral rights will revert to the mineral interest owners (Southland, *et al.*)[1]

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[1] Originally the lease was executed with W. N. Waddell, *et al.* as lessors. Present owners include Southland Royalty Company 47.00%, Trustees under the will of Warren Wright 25.7%, Exxon Corporation 14%, and more than 100 others.

Gulf, *et al.* make percentage type sales to Warren Petroleum Company, now a division of Gulf covering certain quantities of casinghead gas produced from the Crane County acreage. Pursuant to two gas purchase contracts, dated January 26, 1951, and March 1, 1972, Warren sells to El Paso approximately 60,000 Mcf per day of surplus residue gas at the outlet of the Waddell Gasoline Plant, and El Paso transports this gas through its jurisdictional facilities for subsequent resale in interstate commerce. Approximately 25,000 Mcf per day of this residue gas comes from wells leased by Gulf, *et al.*

Upon termination of the lease the owners of the mineral interests will hold a fee simple title as reversioners to their pro rata share of the mineral estate underlying the subject acreage. *Gulf Oil Corp.* v. *Southland Royalty Co.,* 496 SW2d 547, 522 Tex. Sup. Ct. 1973 (1973). The mineral interest owners state that they have agreed to sell to Intratex Gas Company the gas from their fee simple estate. Furthermore El Paso says that Exxon has solicited proposals for the purchase of the gas attributable to its reversionary interest rights for resale in intrastate commerce.

On this state of facts on which there is no dispute El Paso seeks an order determining whether Southland, *et al.* may sell the gas from the Crane County leasehold in intrastate commerce without prior permission and approval of the Commission under Section 7(b) of the Natural Gas Act, whether Gulf, *et al.* must obtain the permission and approval

of the Commission to cease making sales to Warren and to transfer their rights to Southland, *et al.*, and whether Warren (now Gulf) may reduce its sales to El Paso to the extent they are attributable to the leasehold property without prior Commission permission and approval.

In like manner on April 8, 1975, Texaco Inc. in Docket No. CI75-594 filed a petition for a declaratory order to determine whether a lessee, by making an interstate gas sale, can commit more than its real property interest (i.e its rights under its lease) thereby both encumbering forever the real estate and imposing upon the nonparticipating mineral fee owner the obligations of Section 7 of the Natural Gas Act. The facts underlying Texaco's petition are similar to those involved in El Paso's petition. In 1925 Gulf, a lessee, and Goldsmith, *et al.* as lessors, executed a 50-year fixed term oil and gas lease by which Gulf obtained exclusive mineral rights to some 19,840 acres in Ector County, Texas, until August 7, 1975, when the mineral rights would revert to Goldsmith, *et al.*, with whom Texaco acquired a 1/4 interest in 1929. Gulf sells gas from the Ector County leasehold to Phillips Petroleum Company under a percentage-type casinghead gas sales contract, and Phillips sells the residue gas from the tailgate of its Goldsmith Plant to El Paso. Approximately 18,000 Mcf per day of the residue gas sold to El Paso by Phillips is attributable to the Ector County lease. Texaco says that it has knowledge of these sales contracts but is not a party to either one.

On June 3, 1975, after a petition by Texaco, the Commission consolidated Docket Nos. CP75-209 and CI75-594 because of the similarity of the facts and legal questions, found that because there was no factual dispute and no request for a hearing there was no need to hold an evidentiary hearing, and provided opportunity for filing briefs. Accordingly, initial briefs were filed on June 20, 1975, or thereabouts, by Mineral Interest Owners, El Paso, Texaco, Gulf, People of the State of California and the Public Utilities Commission of the State of California, Exxon, Mitchell Energy Corporation and the Staff. Reply briefs were filed on June 25, 1975, by Mineral Interest Owners, El Paso, Texaco, Exxon, Phillips and the Staff.

On July 2, 1975, Exxon filed a motion requesting the Commission to include protective relief in any final order in the form of payback of volumes of gas if the Commission's order is reversed on review. The Mineral Interest Owners responded on July 3, 1975, supporting Exxon's motion on the basis of their understanding of it. By telegram of July 7, 1975, Gulf also supported the motion, and El Paso concurred on July 10, 1975, with a request for an amendment of the protective language.

On the question whether Southland, *et al.* may sell the gas from the Crane County leasehold in intrastate commerce without Commission approval and whether Goldsmith and Texaco may do likewise with respect to the Ector County gas, Mineral Interest Owners, Exxon and Texaco, with the support of Gulf,

argue variously that they are not required to obtain abandonment authority before initiating intrastate sales. They point out that the Commisison has no authority to compel a producer to sell his gas in interstate commerce, and that their royalty interest does not make them sellers of gas in interstate commerce within the meaning of the Natural Gas Act and in no way dedicates their gas to the interstate market. They cite *Mobil Oil Corp.* v. *F.P.C.*, 463 F.2d 256 (CADC 1971), *certiorari denied*, 406 U.S. 976 (1972), where the Court held that royalty owners were ordinarily not sellers of the gas. They note that in the instant case Gulf possessed only a 50-year leasehold right and had no legal authority to sell the gas produced beyond the termination date of the lease.

They rely heavily on *El Paso Natural Gas Co.* v. *Perry R. Bass*, 48 FPC 1269, Opinion No. 638 (1972). There Shell held a farm-out lease from Bass, who retained a royalty with the option after Shell recovered the cost of drilling to receive in lieu of the royalty a ½ working interest in the lease. Shell later sold gas from its "properties" to El Paso, and El Paso was to purchase from seller's "interest" in the wells. Still later Bass notified Shell of its election to accept a working interest and attempted to sell its working interest gas to Natural Gas Pipeline Company, but El Paso objected. The Commission held that the Shell-El Paso contract did not purport to cover any gas save that produced from the properties owned by Shell, that Bass was a

royalty owner and not a seller, that Section 7(b) did not apply to Bass, that farmouts should be encouraged and that Bass did not have to obtain abandonment authorization before making its sale to Natural.

Texaco also argues that there will be no transfer of rights for the Commission to consider when Gulf's leases expire, for the leasehold estates will vanish and the reversion will occur by operation of law. Texaco also contends that the Commission lacks authority to adjudicate matters of title and must conform to state law, citing *Erie Railroad Company* v. *Tompkins*, 304 U.S. 64 (1938). Both Texaco and Exxon also argue that they would be deprived of their properties without due process of law in violation of the Fifth Amendment if they were forced to sell their gas to El Paso after Gulf's leases terminate.

El Paso takes a contrary view. It says that once natural gas begins to flow in interstate commerce it becomes dedicated and Section 7(b) provides the exclusive means of terminating the service. The lessees have dedicated the gas produced by their wells and regardless of the termination of the lease, service must continue. It contends, further, that the reversionary interest owners step into the shoes of their predecessors, Gulf, *et al.*, and take the properties subject to the interstate dedications. It emphasizes that abandonment should not be permitted without a proceeding to determine that there is no betrayal of justifiable public reliance on the gas involved.

California says that the emphasis should not be placed on the contractual arrangements but on the

fact that the gas is currently dedicated to interstate commerce by physical movement in El Paso's pipeline. California also argues that the *Mobil* case should not apply and that in any case the reversionary owners are like the sellers of leases in the *Rayne Field* case, *U.G.I.* v. *Continental Oil Co.*, 381 U.S. 392 (1965).

It is the position of the Staff that the gas from the subject acreage, whether produced before or after expiration of the leases, is dedicated to the interstate market and that by virtue of their control over the gas the reversioners are subject to the constraints of Section 7(b). Staff adds that once the reserves are dedicated to the interstate market they become a part of the Commission's regulatory scheme, safeguarded by Section 7(b) to insure continuity and stability of service.

In our opinion the various mineral interest reversioners may not sell gas from the two leaseholds in intrastate commerce without prior permission and approval of the Commission. Although we have discovered no case directly in point, we are of the opinion that the cases and the purpose of the Natural Gas Act inevitably lead to this view. In the first place, the dedication involved is not the dedication of an individual party or producer, but the dedication of gas. In *CATCO, Atlantic Refining Co.* v. *P.S.C. of New York*, 360 U.S. 378 (1959), the Court said that once gas is dedicated "there can be no withdrawal of that supply from continued interstate movement without Commission approval." Further-

more, contractual arrangements are not controlling as to whether the gas may be withdrawn from dedication. In *Sunray Mid-Continent Oil Co.* v. *F.P.C.*, 346 U.S. 170 (1960) the Court upheld the Commission in granting an unlimited term certificate. The Court noted that the "service in which the producer engages is distinct from the contract which regulates his relationship with the transmission company in performing the service". Here a service is being rendered by Gulf to El Paso utilizing the gas in the Crane County and Ector County leases.

Because of the termination of the 50-year leases the lease holders, Gulf *et al*, lose their leases and their rights pass to Southland, *et al* in one case and to Goldsmith, *et al* and Texaco in the other case. Of course, we have determined that gas may not be withdrawn from interstate commerce by the assignment of leases from one lessee to another. *Cumberland Natural Gas Company*, 34 FPC 132 (1965); *Blair-Vreeland*, —— FPC ——, Opinion No. 724, Docket No. CI74-331, March 18, 1975. But we do not rest our conclusion on these cases, but on the principle established by Section 7(b) that "service" may not be abandoned without our permission and approval. Thus it makes no difference whether a lease is transferred or terminates, the obligation of service imposed upon the dedicated gas continues. As said in *Hunt* v. *F.P.C.*, 306 F.2d 334, 342 (CA5, 1962), rev'd on other grounds, 376 U.S. 515 (1964), the duty to continue to serve is like an ancient covenant running with the land. This does not mean that we are modi-

fying the law of Texas as to the leasehold rights; we are however recognizing rights and duties that have been created by the Congress under the Natural Gas Act. Nor are we depriving the reversioners of their property without due process of law, for we are merely holding that their property is subject to a Section 7(b) proceeding and, in any case, they will be compensated for any continued interstate sales under the Natural Gas Act.

The *Mobile* case does not call for any different result. Under that case the mineral interest owners in each of the leaseholds are not natural gas companies. However, the gas has been dedicated to interstate commerce and was being sold in interstate commerce by Gulf, *et al.* It cannot be sold in intrastate commerce, and the sales in interstate commerce abandoned without our permission and approval under Section 7(b).

The *Bass* case, which did not involve the diversion of gas from interstate commerce, likewise does not alter our result. There the lessee, Shell, by means of its contract with El Paso, plainly intended to provide a service based upon the dedication of its interest in the leasehold, not the interest of Bass, who had the right to receive a 1/2 working interest in lieu of his royalty. The interstate dedication thus covered only part of the leasehold, while here the leaseholds were wholly dedicated to interstate commerce. In any case, we believe that the broad language used in *Bass* should be confined to the facts of the case and not extended to the difficult situation here involved. We therefore

conclude that Section 7(b) applies to the sale of the gas from the dedicated reserves in the two leaseholds involved here until they are exhausted.

Mitchell Energy argues that should the mineral interest owners be held to be subject to Section 7(b) it would be erroneous for the Commission to exercise any jurisdiction over any reserves not connected to facilities rendering jurisdictional service. Thus undiscovered and undeveloped reserves, it says, fall beyond the Commission's jurisdiction over abandonment. Mitchell Energy is arguing over again the issues which it raised in Opinion No. 733, *Mitchell Energy Corporation*, —— FPC ——, Docket No. CI75-296, issued June 11, 1975. We believe those issues are adequately covered in that opinion.

As to whether Gulf, *et al.* must obtain abandonment permission in order to cease sales to Warren and transfer their rights to Southland, *et al.*, El Paso argues that the lessees have dedicated the natural gas produced by their wells to interstate commerce and may not cease making sales of the gas from these wells without abandonment authorization. El Paso indicates, however, that because Gulf has merged with Warren, Gulf would not have to obtain abandonment of its sale to Warren, but would to Phillips. Gulf itself points out that by virtue of the merger of Warren into Gulf there are no sales of gas between Gulf and Warren. Exxon says that with the expiration of the 50-year lease, El Paso's right to purchase production from Gulf ceases and so it does not require abandonment authorization.

Staff says that an abandonment application by lessees would be superfluous and inconsistent with the purpose of Section 2.64 of the Commission's General Policy and Interpretations to avoid unnecessary filings. However, as El Paso argues, Section 154.91(e) of the Commission's Regulations leaves subject to Section 7(b) producers making percentage-type sales to plant operators selling gas in interstate commerce. Therefore it would seem that Gulf would have to file for abandonment of its sales to Phillips, and the other lessees would have to file for abandonment of their sales to Phillips and Gulf's former affiliate Warren, now part of Gulf. In our opinion this is not a mere technical requirement as staff would have it but would allow as to pass upon the merits of the lessees' abandonments upon the termination of the 50-year leases as well as the proposed abandonment of the reversioners, who want to remove the gas from interstate commerce. We should have all the significant parties before us if the relations between the reversioners, lessees, processing plants, and El Paso are to be changed.

As to whether Warren and Phillips may reduce their sales to El Paso without prior Commission permission and approval El Paso points out that the sales are in interstate commerce and abandonment authorization must be obtained if the quantities are to be permanently reduced even though the contracts provide for the sale of only surplus residual gas. Gulf points out that Warren now means Gulf and says that upon expiration of the fixed term

leases the gas produced therefrom will no longer contribute to the surplus residue gas Gulf could sell to El Paso, that the gas will belong to the reversioners, and that Gulf will have no control over it. The Staff, Exxon and Phillips say that under Section 154.91(e) of the Regulations the only obligation on a plant operator is to file an annual report listing any changes in the producers from whom the gas is purchased.

In our opinion the Commission did not intend to exempt plant operators from the requirement that they apply under Section 7(b) for abandonment of their sale to the extent that the sale has been reduced by a substantial and permanent loss of supply. Therefore the two plant operators Gulf (Warren) and Phillips should make applications under Section 7(b) if they lose substantial amounts of the gas they sell to El Paso upon termination of the 50-year leases.

In its motion of July 2, 1975, Exxon argues that whether the Commission acts before July 14, 1975, or thereafter, the Commission's action may impose obligations upon a party which will result in irreparable injury to that party if the Commission order should be reversed upon court review. It points out that it would not be desirable to shut in production pending action upon a request for stay since such action would result in interruption of oil and gas production and possible permanent damage to the wells. It requests that the Commission in its final order in this proceeding include language intended to protect all parties pending ultimate judicial review.

Briefly Exxon would require that if the Commission requires abandonment authorization for the mineral interest owners, as we have here, and it should be determined on review that the gas may be sold to others than El Paso without abandonment authority, then any deliveries by Southland, Exxon or other mineral interest owners shall not constitute a dedication of their gas to the interstate market, acceptance of monies shall not prejudice the rights of the mineral interest owners to claims for any rate different from the rate tendered by El Paso, and El Paso shall be required to repay Southland, Exxon and the other mineral interest owners in gas for the deliveries made to it during judicial review. Mineral Interest Owners state their support of Exxon's motion with certain reservations. El Paso concurs with Exxon's conclusion as to the need for protective language in the Commission's order. However, since payback of gas either to or by El Paso will affect directly El Paso's level of service to the interstate market, El Paso believes that Exxon's language should be amended by requiring payment subject to further Commission order.

In our opinion it is not appropriate for us under the Natural Gas Act to include the protective provisions requested by Exxon. We believe that if the parties need protective provisions in the form of a stay, payback of gas volumes or otherwise, they should address themselves to the appropriate court.

The Commission orders:

(A) In accordance with the above discussion:

(1) Southland, *et al.*, Exxon, Goldsmith, *et al.*, Texaco and other mineral interest owners of gas reserves in the Crane County and Ector County leases involved here may not, upon termination of the leases, sell gas in interstate commerce without prior permission and approval of the Commission under Section 7(b) of the Natural Gas Act;

(2) Gulf, itself, need not obtain abandonment permission and approval to cease sales to its division, Warren, but other lessees must do so, and Gulf must do so with respect to its sales to Phillips;

(3) Gulf, formerly Warren, and Phillips may not reduce their sales to El Paso to the extent such sales are attributable to production from the subject leasehold property without prior Commission permission and approval.

(B) Exxon's motion to include protective language in the Commission's order is denied.

By the Commission.

(S E A L)

MARY B. KIDD,
Acting Secretary.

APPENDIX D

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Opinion No. 737-A

Docket No. CP75-209

EL PASO NATURAL GAS COMPANY

Docket No. CI75-594

TEXACO INC.

OPINION AND ORDER DENYING REHEARING
BUT ADOPTING PER CURIAM

Issued: September 3, 1975

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: John N. Nassikas, Chairman; William L. Springer and Don S. Smith.

Docket No. CP75-209

EL PASO NATURAL GAS COMPANY

Docket No. CI75-594

TEXACO INC.

Opinion No. 737-A

OPINION AND ORDER DENYING REHEARING BUT ADOPTING PER CURIAM

(Issued September 3, 1975)

Texaco Inc. on August 4, 1975, a group of Mineral Interest owners and Exxon Corporation on August 8, 1975, Gulf Oil Corporation (Gulf) and El Paso Natural Gas Company, on August 11, 1975, and Mobile Oil Corporation on August 13, 1975, have filed applications for rehearing of the Commission's Opinion No. 737 and order issued July 18, 1975, in the above-entitled proceedings. In Opinion No. 737 the Commission determined that the various mineral interest owners holding reversionary interests in 50-year leases covering certain gas reserves in Crane County and Ector County, Texas were subject to the dedications made by the leaseholders, Gulf and

others,[1] for the sale of the gas in interstate commerce to El Paso Natural Gas Company and that, upon termination of the leases, they might not sell gas in intrastate commerce without obtaining abandonment approval under Section 7(b) of the Natural Gas Act. The Commission also determined that Gulf need not obtain permission to cease sales to Warren Petroleum Company, now a division of Gulf, but that other leasees must do so, and that Gulf must do so with respect to its sales to Phillips Petroleum Company for resale to El Paso. Further, Gulf, formerly Warren, and Phillips may not reduce their sales to El Paso to the extent such sales are attributable to production from the subject property without prior Commission permission.

The applications for rehearing largely involve restatements and amplification of the arguments already made and covered in Opinion No. 737. The mineral interest owners contend that the only service dedicated to interstate commerce was the service of delivering all of the gas attributable to the fixed-term leaseholds estates. Just as half of the gas from a well may be dedicated to interstate commerce and half to intrastate commerce here, they say, only the leasehold interests were dedicated to interstate commerce. In our opinion there is a difference. Predecessors of Gulf commenced the service of delivering gas from the reserves here involved to interstate com-

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[1] As here used Gulf includes the other leaseholders and predecessors.

merce. Gulf could have at the same time commenced delivering part of the gas here involved to intrastate buyers, and we would recognize such an intrastate dedication. Here, however, we are solely concerned with the service commenced by Gulf to El Paso in interstate commerce. Under Section 7(b) of the Natural Gas Act this service may not be abandoned without the permission of the Commission. Nor, as we said in Opinion No. 737, can this service be discontinued by transfer to a successor interest. For the practical purposes of the Act it makes no difference whether the successors happen to be assignees, purchasers or reversionary interests. While the contractual right to control and sell the reserves here involved has passed from Gulf to the various mineral interests, this does not mean that under the Natural Gas Act the gas flowing in interstate commerce may be diverted to the intrastate market. As said in *Huber Corp.* v. *F.P.C.*, 236 F.2d 550, 558 (CA3 1956), Congressional power to regulate interstate commerce in natural gas includes authority to regulate abandonment of sales.

Several of the applicants for rehearing argue, as they have previously, that *El Paso* v. *Bass*, 48 FPC 1269, Opinion No. 638 (1972) is contrary to our position here. There Bass entered into a farmout agreement with Shell to develop a producing area retaining a 1/8 overriding royalty with an option to convert it to a 1/2 working interest. Shell later entered into an agreement to sell gas to El Paso from "seller's interest in wells". Still later Bass exercised his op-

tion to convert to a working interest and proposed to sell his share of the gas to another pipeline. The Commission held that Bass might do so without obtaining abandonment authorization.

The chief differences between the *Bass* situation and the present one is that the Shell sale agreement pointedly made it clear that Shell was only selling gas from its interest in the properties involved while in the present case Gulf had a long leasehold interest and sold surplus residue gas available from its leasehold properties. To the extent, however, that *Bass* can be said to stand for the proposition that the service initiated by the leaseholder based upon certain gas reserves covered by the lease can be terminated without Commission approval, it is overruled. It should be noted that Bass did not involve the shift of gas reserves from interstate to intrastate commerce and did involve the public interest in the encouragement of farmouts, and these circumstances, in part, explain the result in *Bass*.

The Mineral Interest Owners, Exxon and Texaco argue variously that we have violated the property law of Texas, the Tenth Amendment to the United States Constitution reserving to the states powers not granted to the Federal Government, and the Fifth Amendment by depriving them of property without due process of law. The essence of the argument appears to be that we are in error in holding that the leaseholders, Gulf *et al.*, had power to encumber the property with the result that the mineral lease owners are forced to enter into an interstate sale against

their will. We assume that in 1925, when the leases were made the lease owners did not contemplate that the Natural Gas Act would be enacted with a provision that service might not be abandoned without approval of the Commission. They clearly did contemplate that the leaseholders would drill for oil and gas and sell oil and gas to outside parties, and there was no reason that these sales could not be in interstate commerce, and may have had a duty to do so under the facts and law at that time. After the Natural Gas Act was enacted in 1938 and the *Phillips* case [2] was decided in 1954 the interstate sales of gas became subject to FPC jurisdiction. The leaseholders who had a duty to exploit the wells were the appropriate parties to seek FPC certification. Upon the commencement of interstate sales under FPC certification, the sales became imbued with the public interest.[3] The law of Texas preserved for the lease owners their property interest, and we do not change this, but Section 7(b) of the Act will not permit abandonment of interstate sales without our authority once such sales have commenced. The mineral lease

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[2] *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954).

[3] The lease owners could have intervened in the proceedings granting certificates to Gulf and Phillips Petroleum Co. to sell the gas to El Paso but our records do not reveal that they have done so. See orders dated May 28, 1956, in Docket No. G-7156, September 28, 1956, in Docket No. G-2625, 16 FPC 1440, and February 24, 1958, in Docket No. G-13445, 19 FPC 1151, among others. However, the lease owners apparently had no objection to this interstate dedication, for they accepted royalties from such sales.

owners who entered into a lease that permitted the lease holders to make interstate sales are not deprived of this property by being required to permit such sales to continue, and they will be compensated under the just and reasonable rates promulgated under the Natural Gas Act.

These considerations, in our opinion, answer the argument of Exxon that it is being forced to make a sale at the termination of Gulf's leasehold interest and that this constitutes an unlawful taking under the Fifth Amendment. The sale of gas was already being made from the properties here involved before the advent of regulation. Exxon or its predecessors had leased the properties for this purpose. The imposition of regulation did not constitute an unlawful taking. *Nebbia* v. *New York*, 291 U.S. 502 (1939); *F.P.C.* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 582 (1942). A producer contracting to sell gas in interstate commerce before regulation commences is properly subject to Section 7(b) although he may never have contemplated such a result. See *Harper Oil Co.* v. *F.P.C.*, 284 F.2d 137 (CA10 1960). Here Exxon is not being forced to make an initial sale but is required to conform to the Natural Gas Act when it succeeds to the interest of Gulf.

The Mineral Interest Owners, Exxon and El Paso argue that the Commission should provide protective relief, *pendente lite.* In Opinion No. 737 we discussed a proposal by Exxon that if we required abandonment authorization for the mineral interest owners, as we had, and if it were determined on judicial re-

view that the gas might be sold to others than El Paso without abandonment authority, then any deliveries by the mineral interest owners should not constitute a dedication of their gas to the interstate market, acceptance of monies should not prejudice their right to a different rate, and El Paso should be required to repay them in gas for deliveries made to it during judicial review. However, we determined that it was not for us to include the protective provisions and that the parties should address themselves to the appropriate court.

Since Opinion No. 737, the Mineral Interest Owners on July 14, 1975, obtained a temporary stay of the Commission's order in the United States Court of Appeals for the Fifth Circuit. As of the same date upon the consent of Southland Royalty Company et al., Exxon, El Paso and the Commission, the Court issued an Interim Protective Order containing language corresponding to Exxon's proposal set forth here in ordering clause (B). The Court's order provided that it should be effective until a petition for review of the final Commission order on rehearing of Opinion No. 737 is filed in a court of appeals and any concurrently filed motion for stay or protective order is decided by the court of appeals and further judicial review is exhausted. The Court's order noted that the FPC represented that it did not concede that the Court had jurisdiction to enter a protective order in this matter, but in order to settle a controversy inasmuch as the Court had determined to act, the F.P.C. had represented that it believed that the foregoing

provisions were the most equitable matter of preserving the status quo, and it would not move to vacate this order.

On August 4, 1975, Southland Royalty Company and El Paso entered into a letter agreement providing protective provisions and other terms for the continued delivery of gas to El Paso. The Mineral Interest Owners explain that due to the large number of people and distances involved the mineral interest owners, other than Southland, have not yet executed a formal document, but have agreed to it in principle.

More specifically, the letter agreement provides that where Southland is compelled to deliver gas to El Paso by Opinion No. 737 or any other order of the Commission or the courts the initial rate shall consist of the higher of 76.5 cents per Mcf plus certain adjustments, 150% of the national rate, or any higher rate that El Paso is permitted to pay. If El Paso is prevented from including this cost of gas in its rates, Southland is to refund to El Paso the amount disallowed. In the event Southland prevails upon rehearing of Opinion No. 737 and delivers gas elsewhere and later it is determined that Southland should have continued to make deliveries to El Paso there are requirements for the payback of volumes of gas to El Paso. In the event that the Commission's determination in Opinion No. 737 is reversed, and it is determined that the gas could have been sold to others than El Paso, there are requirements for the payback of gas by El Paso to Southland similar to those in the Court order discussed above.

El Paso and Southland also agree to request the Commission to include protective payback provisions in its order in accordance with the letter agreement and that these protective provisions shall be the sole measure of damages and liability as between El Paso and Southland. Attached to the letter agreement are general terms and conditions for the delivery of gas by Southland and payment thereafter by El Paso.

In our opinion the letter agreement misconceives the legal situation of the parties. Deliveries to El Paso must continue to be made by Gulf and Phillips as before the termination of the leases until new rate filings are made in accordance with the Commission's Regulations substituting Southland, Exxon and other parties for those originally serving El Paso, unless permission is obtained from the Commission to abandon the service to El Paso. We observe further that until appropriate rate filings are made by Southland and other mineral interest owners we cannot resolve the issues raised by the agreement of August 4, 1975. Because of the Court order, however, putting in effect protective language to cover the situation where gas deliveries to El Paso continue, we think it appropriate to adopt this same language, as El Paso requests in its application for rehearing, to cover the period until our order becomes final.

The Commission further finds:

(1) The assignments of error and ground for rehearing set forth in the application for rehearing

filed by Texaco, the Mineral Interest Owners, Exxon, Mobil and Gulf in these proceedings present no facts or legal principles that would warrant any change in or modification of the Commission's Opinion No. 737 and the accompanying order except as provided below.

(2) It is necessary and appropriate in the administration of the Natural Gas Act that the application for rehearing filed by El Paso be granted and that the protective language below be adopted to cover the period until our order becomes final.

The Commission orders:

(A) The applications for rehearing filed by Texaco, the Mineral Interest Owners, Exxon, Mobil, and Gulf are denied; the application for rehearing filed by El Paso is granted.

(B) If Southland, Exxon, or any other mineral interest owners should seek review of this order and upon review it should be ultimately determined that the gas may be sold to others than El Paso without abandonment authority, then any deliveries by Southland, Exxon, or the other mineral interest owners pending such judicial review shall not have constituted a dedication of their gas to the interstate market and acceptance of monies paid for gas delivered pending judicial review shall not prejudice the rights of the mineral interest owners' rights in the premises; further, El Paso shall be required to repay Southland, Exxon, and the other mineral interest owners in gas for the deliveries made to it pend-

ing judicial review. Such repayment is to be made by El Paso subject to the following conditions: (a) the pay-back volumes are to be delivered, in an equitable manner over a reasonable period of time, subject to further Commission order as to scheduling but not as to entitlement if El Paso, Southland, Exxon, and the other mineral interest owners cannot agree as to such scheduling, (b) Southland, Exxon, and the other mineral interest owners shall return to El Paso the monies paid for deliveries made pending judicial review, such repayments to be made within thirty (30) days following the end of each calendar month during which pay-back volumes are delivered by El Paso, and (c) the pay-back volumes shall not be considered to be jurisdictional gas and acceptance thereof by Southland, Exxon, or the other mineral owners, or any of their customers, shall not subject any of them to Commission jurisdiction.

By the Commission.

[SEAL]

KENNETH F. PLUMB,
Secretary.

APPENDIX E

The Natural Gas Act, 52 Stat. 821-833, as amended, 15 U.S.C. 717-717w, provides in pertinent part:

Section 1(b):

The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas. [15 U.S.C. 717(b)]

Section 7(b):

No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment. [15 U.S.C. 717f(b)]

Section 7(c):

No natural-gas company or person which will be a natural-gas company upon completion of

any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: *Provided, however*, That if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on February 7, 1942, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after February 7, 1942. Pending the determination of any such application, the continuance of such operation shall be lawful.

In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: *Provided, however*, That the Commission may

issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest. [15 U.S.C. 717f(c)]

Section 7(e):

Except in the cases governed by the provisos contained in subsection (c) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of the Act and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require. [15 U.S.C. 717f(e)]

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No. 76-1587

In the Supreme Court of the United States

OCTOBER TERM, 1976

FEDERAL POWER COMMISSION, PETITIONER

v.

SOUTHLAND ROYALTY COMPANY, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF FOR THE FEDERAL POWER COMMISSION

WADE H. MCCREE, JR.,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

DREXEL D. JOURNEY,
General Counsel,
Federal Power Commission,
Washington, D.C. 20426.

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1. Southland claims that the Commission misstates the question presented. Specifically, Southland claims that the Commission asks whether gas which has been "dedicated to interstate commerce" can be "withdraw[n]" without abandonment authorization under Section 7(b) of the Natural Gas Act, 52 Stat. 824, 15 U.S.C. 717f(b); whereas, in Southland's view, the question is "whether Gulf had dedicated Southland Royalty's gas in the first place" (Br. in Opp. 6).

However, in so characterizing the Commission's formulation of the issue in the case, Southland ignores the "Question Presented" explicitly stated in the Commission's petition (Pet. 2). There the question is put in terms of whether the lessor under an expired lease may, without abandonment authorization, "withdraw gas from

interstate commerce after the lessee, during the lease term, had sold gas from the leaseholds in interstate commerce and had obtained from the Commission certificates of public convenience and necessity of unlimited duration authorizing that service." Manifestly, the question is whether the interstate sale of leasehold gas authorized by a Commission certificate creates a "service" that may not be discontinued without abandonment authorization. Southland, in putting the issue in terms of whether the gas had been dedicated "in the first place," merely restates the same question.

2. Southland cites *Meyers* v. *Famous Realty, Inc.*, 271 F. 2d 811 (C.A. 2), certiorari denied, 362 U.S. 910, for the proposition that under the Interstate Commerce Act "the regulated activities of a lessee do not subject a non-regulated lessor to the agency's jurisdiction" (Br. in Opp. 9-10). In that case, as Southland notes, the court refused to require the railroad lessor to continue the operation of a railroad line after termination of the lease. However, Southland neglects to note that the lessee in that case had previously been authorized by the Interstate Commerce Commission to abandon the service. 271 F. 2d at 813-814. On its facts, therefore, *Meyers* holds only that, where the lessee has previously been authorized to abandon the service, the non-operator lessor will not similarly be required to obtain abandonment authorization prior to termination of the same service. That holding is entirely consistent with the Commission's holding here (J.A. 611) that Gulf Oil Corporation, the lessee, despite the expiration of the lease, would be required to obtain abandonment authorization before abandoning the sales from the Crane County acreage. As explained in our petition (pp. 15-18), the principle of the railroad cases, including *Meyers*, is that, once railroad operations are commenced under lease, the service cannot be terminated unless some party, either the lessor or the lessee,

obtains abandonment authorization. In the words of this Court, "a certificate is required under §1(18) whether the lessee or the lessor is abandoning operations." *Smith* v. *Hoboken Railroad, Warehouse and Steamship Connecting Co.*, 328 U.S. 123, 130.

Southland also urges that the grantors of the railroad leases were "carriers by railroad" when they granted rights and "as such, they were subject to a 'revived obligation' under Section 1(18) [of the Interstate Commerce Act] * * *" (Br. in Opp. 10), whereas its predecessors were not "natural gas companies" when they leased property to Gulf. However, in the *Chicago & Alton* case discussed on pp. 16-18 of our petition, the grantor entered into the railroad leases *prior* to becoming a certificated carrier following the enactment of the certification and abandonment provisions in the Transportation Act of 1920. Thus, the need to obtain abandonment authorization was—as here—a regulatory consequence imposed on the reversioners by the action of their lessees in obtaining certificates of public convenience and necessity.

3. Southland attempts to minimize the significance of the decision below by noting that the lease in question was a fixed-term lease; whereas today, "[v]irtually all producers of natural gas operate pursuant to leases which continue for a stated primary term *and* 'as long thereafter as oil, gas or other minerals are produced [from the subject acreage] in paying quantities' " (Br. in Opp. 12; footnote omitted). The court below, however, has recently interpreted its decision in this case as applying equally to such life-of-the-well leases. *Pennzoil Producing Company* v. *Federal Power Commission*, C.A. 5, No. 76-1626, *et al.*, decided June 6, 1977.

In that case, producers sought special relief from Commission ceiling rates in order to pay their lessors, grantors of life-of-the-well leases, royalties based on the unregulated "market value" of the leasehold gas. When the producers raised the spectre of cancelled leases and the consequent diversion of gas from the interstate market, the Commission concluded that "[i]f the leases were cancelled and Williams were to undertake to sell the subject gas, Williams would simply assume the obligations of Pennzoil and Shell to continue service to United."[1] The court characterized this Commission view as follows (slip op. 3557):

> Thus the Commission was under the impression that Williams' gas was trapped in the interstate market, whether or not the leases were terminated.

Noting its decision in the present case, the court concluded that "the Commission was acting under the wrong legal premise" (*ibid.*). The court added (*ibid.*):

> It may well be that the "present or future public convenience or necessity" will suggest the propriety of abandoning a fraction of the gas in Williams' property, rather than lose the entire amount from the interstate market.

The court of appeals has thus construed its decision in the present case in a way that would permit any gas sold in interstate commerce pursuant to Commission certificates to be withdrawn from that service without Commission approval upon the occurrence of any subsequent event which terminates the lease. *Pennzoil* thus casts in

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[1]Opinion No. 753, *Pennzoil Producing Co., et al.*, Docket No. R176-8, *et al.*, issued January 30, 1976, p. 9.

bold relief the court's fundamental error here of confining certificated public service obligations to the adventitious terms of private leases.

Respectfully submitted.

WADE H. MCCREE, JR.,
Solicitor General.

DREXEL D. JOURNEY,
General Counsel,
Federal Power Commission.

JUNE 1977.

DOJ-1977-06

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-11a)[1] is reported at 543 F.2d 1134. The initial opinion and order (No. 737) of the Federal Power

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[1] "Pet. App." references are to the appendix to the petition for certiorari filed by the Federal Power Commision in No. 76-1587. "A." refers to the Appendix in this Court.

Commission (A. 598-611) and its opinion and order (No. 737-A) denying rehearing (A. 708-718) are reported at 54 FPC 145 and 54 FPC 917, respectively.

JURISDICTION

The judgment of the court of appeals was entered on December 13, 1976 (Pet. App. 12a-13a). On March 3, 1977, Mr. Justice Powell extended the Commission's time for filing a petition for a writ of certiorari to and including May 12, 1977, and the petition was filed on that date. On June 27, 1977, the Court granted the petition in this case, No. 76-1587, and in two related cases: *California, et al.* v. *Southland Royalty Company, et al.*, No. 76-1114, and *El Paso Natural Gas Company* v. *Southland Royalty Company, et al.*, No. 76-1133, and consolidated the three cases (A. 746). The Court's jurisdiction rests on 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, as amended, 15 U.S.C. 717r(b).

QUESTION PRESENTED

Whether the lessors of land and their successors in interest, at the expiration of a 50-year lease, must obtain abandonment authorization from the Federal Power Commission under Section 7(b) of the Natural Gas Act before they may withdraw gas from interstate commerce after the lessee, during the lease term, had sold gas from the leaseholds in interstate commerce and had obtained from the Commission certificates of public convenience and necessity of unlimited duration authorizing that service.

STATUTES INVOLVED

Sections 1(b), 7(b), (c), and (e) of the Natural Gas Act, 52 Stat. 821, 824-825, as amended, 15 U.S.C. 717(b), 717f(b), (c), and (e), are set forth as Appendix A, *infra*, pp. 1a-3a.

STATEMENT

In this case the Federal Power Commission held that, once a natural gas producer has made natural gas sales for resale in interstate commerce pursuant to a Commission certificate of unlimited duration, the reserves of natural gas underlying those sales may not be withdrawn from that service without Commission authorization, where the asserted basis for the withdrawal is the termination of the lease between the mineral interest owners and the natural gas producer. On review, the court of appeals held that, by virtue of local property law, the termination of the lease is a sufficient basis for the cessation of sales in interstate commerce and there is no need to obtain abandonment authorization from the Commission.

1. The Leases, Interstate Sales and Certificates.

On July 14, 1925, Gulf Oil Corporation (Gulf), then Gulf Production Company, executed an oil and gas lease with W. N. Waddell and others (the Waddell Lease), under which Gulf obtained the exclusive right to explore, produce and market all oil and gas from 45,771 acres of land in Crane County, Texas (A.

135-140). The lease provided that Gulf would also have "such other privileges as are reasonably requisite for the conduct of said operations" (A. 135), and that the lessor would receive a royalty based on the quantity of natural gas produced and the number of producing wells (A. 137). It further provided that the "lease shall not remain in force longer than fifty (50) years from this date * * *" (A. 136).

In 1951 and 1972, Gulf entered into contracts with El Paso Natural Gas Company (El Paso), an interstate pipeline company, for the sale of a quantity of "surplus residue gas"—that is, a portion of the end product of Gulf's processing of gas—from wells on the Waddell Lease and from other sources (A. 40-63, 87-101).[2]

After the decision of this Court in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, Gulf applied for and obtained from the Commission certificates of public convenience and necessity of unlimited duration authorizing the service to El Paso. These were

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[2] Gulf operates a natural gas processing plant which, in essence, refines natural gas issuing from oil wells (called "casinghead gas," as distinguished from "gas-well gas") by removing certain elements. Gulf's sales contracts with El Paso define "residue gas" as "the gas which remains after casinghead gas has been processed," less the amounts used in the operation of the plant (A. 42, 88). The contracts define "surplus residue gas" as the residue gas remaining after the satisfaction of certain specified needs and obligations of Gulf (*ibid.*). Gulf's processing plant obtained casinghead gas from a number of sources, including wells on the Waddell Lease (A. 123).

issued on May 28, 1956 (A. 23-40) and August 7, 1973 (A. 102-116).

On July 14, 1975, the Waddell Lease expired [3] and title to the mineral estate reverted to the reversionary mineral interest owners.[4]

On August 7, 1925, Gulf entered into a similar 50-year fixed-term oil and gas lease with Goldsmith and others (the Goldsmith Lease) under which Gulf obtained exclusive mineral rights to some 19,840 acres in Ector County, Texas (A. 293-297).[5] Gulf sold gas from the Goldsmith Lease to Phillips Petroleum Company (Phillips), which processed the gas and sold it to El Paso at the outlet of Phillips' Goldsmith plant pursuant to certificates of public convenience and necessity granted by the Commission (16 FPC 1440). El Paso in turn transported the gas in interstate commerce for subsequent resale. The Goldsmith Lease expired on August 7, 1975, and title to the mineral estate reverted to the reversionary mineral interest owners.[6]

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[3] See *Gulf Oil Corporation* v. *Southland Royalty Company*, 496 S. W. 2d 547 (Tex. Sup. Ct.).

[4] Before the lease expired Southland Royalty Company (Southland) and more than 100 other companies and persons acquired fractional shares of the reversionary interest (see A. 149-165).

[5] On May 4, 1929, Texas, Inc. (Texaco), then the Texas Gas Company, acquired a one-fourth interest in the reversionary mineral estate of the Goldsmith Lease (A. 297).

[6] For the purposes of this case, the parties are agreed that there are no material differences between the Goldsmith and Waddell leases or between the obligations, if any, of the re-

2. The Proceeding Before The Commission.

In January 1975, El Paso petitioned the Commission to declare whether, when the Waddell Lease expired, the reversionary mineral interest owners (Southland *et al.*) could cease deliveries to El Paso and sell the gas in intrastate commerce,[7] without obtaining abandonment authorization from the Commission pursuant to Section 7(b) of the Natural Gas Act, 15 U.S.C. 717f(b). In April 1975, Texaco petitioned for a similar declaration with respect to gas produced from the reserves covered by the Goldsmith Lease.[8] The reversionary mineral interest owners sought to sell the gas intrastate because of the substantial differential that has existed in recent years between the price of unregulated intrastate gas and that of regulated interstate gas.[9] Because of the simi-

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versionary mineral interest owners after the expiration of each lease to continue supplying gas to the interstate market. See Respondents' Br. in Opp., pp. 3-4, n. 10.

[7] Shortly before the end of the lease period, Southland contracted with Intratex Gas Company, an intrastate gas pipeline, for the sale of the gas remaining after expiration of the Waddell Lease (A. 600).

[8] See note 5, *supra*.

[9] See Pet. App. 1a. The court of appeals noted that "[w]hile this opinion was in preparation, the Federal Power Commission announced a dramatic increase in regulated natural gas prices which substantially eliminated this price gap" (Pet. App. 1a, n. 1). The statement is somewhat misleading. In June 1976 the Commission ordered a substantial increase in the regulated national interstate ra[illegible] but the application of that increase was limited to gas issuing from wells commenced

larity of the issues presented, the Commission consolidated the proceedings (A. 362). Because there were no factual issues, no evidentiary hearings were sought or held (*ibid.*).

On July 11, 1975, the Commission issued Opinion No. 737 (A. 598-611), holding that Gulf and Phillips had dedicated the gas underlying the respective leases to interstate commerce pursuant to unlimited certificates of public convenience and necessity and that the reversionary mineral interest owners could not withdraw the gas from interstate commerce without abandonment authorization under Section 7(b). The Commission reasoned that under decisions of this Court "the dedication involved is not the dedication of an individual party or producer, but the dedication of gas" (A. 605). Relying on the principle that once the service of supplying gas in interstate commerce from specific acreage has commenced, it may not be

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after January 1, 1973, and would not apply to gas produced from respondents' wells which were commenced before that date. See FPC Opinion No. 770 (issued July 27, 1976), affirmed *sub nom. American Public Gas Association* v. *Federal Power Commission*, C.A.D.C., No. 76-2000 (June 16, 1977), rehearing denied, August 17, 1977). Moreover, the rate increase approved for "new gas" has not eliminated a substantial disparity between that rate and currently prevailing intrastate prices.

The House of Representatives has recently passed a bill (H.R. 8444, 95th Cong., 1st Sess. (1977) which would extend federal price regulation to intrastate gas and require common rates for interstate and intrastate gas produced by wells commenced after April 20, 1977. That legislation is under consideration in the Senate. Again, that legislation would not affect the large bulk of gas that is currently being produced.

abandoned without Commission approval, the Commission stated (A. 606):

> [T]he duty to continue to serve is like an ancient covenant running with the land [quoting from *Hunt* v. *Federal Power Commission*, 306 F. 2d 334, 342 (C.A. 5), reversed on other grounds, 376 U.S. 515]. This does not mean that we are modifying the law of Texas as to the leasehold rights; we are however recognizing rights and duties that have been created by the Congress under the Natural Gas Act.[10]

The Commission concluded that both the reversionary mineral interest owners and Gulf were required to obtain permission from the Commission before abandoning interstate sales of gas from the reserves underlying the leases.[11]

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[10] The Commission distinguished its earlier decision relied on by respondents, *El Paso Natural Gas Co.* v. *Bass*, 48 FPC 1269, in which the lease gave the lessor an option, after the lessee recovered its drilling costs, to receive in lieu of royalty a one-half working interest in the gas produced. The lessee sold gas from its "properties" to El Paso, the lessor later exercised his option, and the Commission held that the lessor did not need Commission abandonment authority to sell gas from his one-half working interest to an intrastate pipeline. The Commission here declined to extend *Bass* to the facts of this case and expressly overruled its broader implications (A. 607, 712). The Commission has since overruled *Bass* altogether. *Phillips Petroleum Company*, FPC Opinion No. 750 (issued January 1, 1976).

[11] The Commission explained that requiring Gulf to obtain abandonment authority was not a "mere technical requirement," because "[w]e should have all the significant parties before us if the relations between the reversioners, lessees, processing plants, and El Paso are to be changed" (A. 608-609).

On petition for rehearing the Commission reaffirmed those findings and conclusions (A. 708-718) and made the additional observation that while the lessors and lessee may not have anticipated the enactment of the Natural Gas Act when they executed the leases in 1925, they did contemplate that Gulf would sell the gas from the leaseholds to outside parties (A. 712-713). The Commission noted that Gulf may even have had a duty under the leases and local law to sell the gas to interstate purchasers (who at that time constituted the principal market for natural gas), and that after the *Phillips* decision Gulf was the appropriate party to seek Commission certification for the interstate sales. The lessors could have intervened in the certification proceeding, but did not, and thus "apparently had no objection to interstate dedication, for they accepted royalties from such sales" (A. 713, n. 3).

3. The Court of Appeals Decision.

The court of appeals reversed the Commission's orders (Pet. App. 1a-11a). The court viewed the issue of interstate dedication as controlled by local law, noting that "[u]nder applicable Texas law, Gulf's rights were those of a tenant for a term of years; its interest was a limited one which terminated completely when title reverted to Southland at the expiration of a 50-year term" (Pet. App. 5a). Thus, "under well established concepts of property law, Gulf could not legally deal in or dedicate that portion of the gas which Southland might own upon termina-

tion of Gulf's estate" (Pet. App. 6a). The court concluded that by virtue of state property law the reversionary mineral owners were free to withdraw their gas from interstate commerce without Commission authorization.[12]

SUMMARY OF ARGUMENT

A. The decision of the court of appeals undermines the Commission's authority under the Natural Gas Act. In holding that the present owners of natural gas reserves may abandon without Commission authorization a "service" in gas based on those reserves, commenced by their lessee and certificated by the Commission, the court has released billions of critically needed cubic feet of gas from their interstate commitment and seriously threatened the Commission's mandate to assure "maintenance of adequate service in the public interest." [13] The decision is con-

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[12] Pending the final disposition of this case, the parties have entered into various agreements whereby the reversionary mineral owners are continuing to supply the gas in interstate commerce subject to the obligation of El Paso, in the event the decision below is sustained, to repay in kind gas delivered after termination of the leases. Pursuant to the parties' request, the Commission incorporated this conditional agreement in its order and made it clear that in the event the Commission's order was reversed on review, the deliveries of gas by the respondents *pendente lite* would not be deemed an interstate dedication of gas by them (A. 717-718).

[13] Section 7(c) of the Act, 52 Stat. 825. This language was later eliminated from the Act, without changing the declared purpose. *Atlantic Refining Co.* v. *Public Service Commission of New York (CATCO)*, 360 U.S. 378, 388 and n. 7.

trary to the fundamental premise of the Act that, once gas is dedicated to interstate commerce by the Commission's issuance of a certificate of public convenience and necessity, "there can be no withdrawal of that supply from continued interstate movement without Commission approval" (*Atlantic Refining Co.* v. *Public Service Commission of New York (CATCO)*, 360 U.S. 378, 389), regardless of intervening changes in property rights with respect to the gas and regardless of "technical concepts of local law." *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392, 400.

B. The decision is also contrary to this Court's construction of the abandonment provision of the Transportation Act of 1920, on which Section 7(b) of the Natural Gas Act was modeled. Decisions of the Interstate Commerce Commission and this Court have long established that the Transportation Act of 1920 requires approval by the ICC before certificated interstate service under a terminated railroad lease can be abandoned. In that context it has been recognized that to make the Commission's jurisdiction over rail service coterminous with railroad leases would enable parties to thwart the national interest in continued interstate service by conducting their business through short-term lease arrangements. The decision below poses the same threat to the nation's vital interest in the interstate supply of natural gas.

C. Moreover, the court of appeals failed to recognize, as courts have recognized in the railroad context, that there is nothing unusual or inequitable in im-

posing on lessors the regulatory consequences of actions by their lessees that benefited the lessors and that were permitted and even required by the lease agreements.

ARGUMENT

When A Lessee Of Gas-Producing Property Has Obtained A Certificate Of Unlimited Duration For The Sale Of The Gas In Interstate Commerce And Has Sold Gas Pursuant To That Certificate, The Lessors May Not Abandon The Service Of Supplying The Gas After Expiration Of The Lease Without The Authorization Of The Federal Power Commission.

A. ***The Natural Gas Act Prohibits The Abandonment Of An Interstate Service In Natural Gas Without The Authorization Of The Federal Power Commission.***

The fundamental purpose of the Natural Gas Act is to assure an adequate and continued supply of natural gas to the nation at reasonable rates. See *Sunray Mid-Continent Oil Co.* v. *Federal Power Commission*, 364 U.S. 137, 147, 151-154; *CATCO, supra*, 360 U.S. at 388. As the court of appeals stated in *Sunray Mid-Continent Oil Co.* v. *Federal Power Commission*, 239 F. 2d 97, 101 (C.A. 10), reversed on other grounds, 353 U.S. 944:

> No single factor in the Commission's duty to protect the public can be more important to the public than the continuity of service furnished.

To implement this purpose, Section 7 of the Act provides that no natural gas company may commence, maintain or terminate an interstate service in natural gas without the permission and approval of the Commission. Thus, no natural gas company "shall engage

in the transportation or sale of natural gas * * * unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations." Section 7(c), 15 U.S.C. 717f(c). Once an interstate service in natural gas has been properly authorized and undertaken pursuant to a Commission certificate under Section 7(e), 15 U.S.C. 717f(e), it may not be terminated without Commission authorization under Section 7(b), 15 U.S.C. 717f (b). The conditions under which abandonment may be authorized are set out in Section 7(b), which provides in pertinent part:

> No natural-gas company shall abandon * * * any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.[14]

The decision of the court of appeals is contrary to basic principles of Section 7 reflected in this Court's decisions, particularly *Sunray Mid-Continent Oil Co.*

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[14] This Court in *CATCO, supra,* 360 U.S. at 389, described the interplay of these provisions as follows:

> Section 7(e) vests in the Commission control over the conditions under which gas may be initially dedicated to interstate use. Moreover, once so dedicated there can be no withdrawal of that supply from continued interstate movement without Commission approval.

v. *Federal Power Commission*, *supra*, and *Sun Oil Co.* v. *Federal Power Commission*, 364 U.S. 170. In those cases the Court recognized that, in light of the purposes of the Act, the primary focus of Section 7 is on the *service* of supplying gas to the interstate market, and not on specific sales of gas or the property interests or contract rights of specific individuals with respect to gas.

In *Sunray*, *supra*, a producer of gas contracted to sell to an interstate pipeline a quantity of gas produced from its fields every year for twenty years. The producer then applied to the Commission for a certificate authorizing the sale for the period of twenty years. The Commission rejected the producer's application for a limited certificate and issued a certificate of unlimited duration. Reserving its right to object to the unlimited certificate on review, the producer commenced deliveries under the contract.

On review, this Court upheld the Commission's authority to issue an unlimited certificate. Moreover, the Court stated (364 U.S. at 155):

> When [the contract] expires, petitioner * * * will be under an obligation to continue to deliver gas to [the pipeline] on the latter's request unless it can justify an abandonment before the Commission * * *. The obligation that petitioner will be under after the contract term will not be one imposed by contract but by the Act.

The Court based its decision on the distinction in Section 7 between specific sales of gas and the "service" of supplying gas to interstate markets (364 U.S. at 149-151):

> [U]nder § 7(e) the Commission is authorized to issue a certificate authorizing the "service" covered by the application, as well as a "sale" * * *.
>
> * * * Thus, it is evident that all the matters for which a certificate is required * * * must be justified in terms of a "service" to which they relate. Accordingly, § 7(e) itself gives positive indication that the "service" which the Commission's certificate may authorize is something quite apart from simply the specific sales which § 7(c) forbids without a certificate sufficient to authorize them.

The Court also recognized that the Commission's power to authorize the service of supplying gas to interstate markets beyond the term of a contract, and to require the continuation of that service notwithstanding changes in the parties' contractual rights to the gas, is essential to the purposes of the Act. The Court noted that if the Commission's authority were limited to granting certificates tied to the duration of contracts, producers would be free to make contractual arrangements which enabled them to cease an interstate supply at their pleasure and to avoid the rate-changing procedures of the Act; pipeline companies, moreover, would have comparable powers that might threaten local communities with economic ruin. 364 U.S. at 142-143.[15]

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[15] As the Court observed (364 U.S. at 142):

> If petitioner's contentions * * * were to be sustained, the way would be clear for every independent producer of natural gas to seek certification only for the limited period of its initial contract with the transmission company, and

In *Sun Oil*, *supra*, the Court applied the principles of *Sunray* to hold that the Commission's order issuing a large number of certificates (including the Gulf certificate in this case) [16] was not limited to the contract period described in the application, but authorized and required the applicant to supply the proposed service (*i.e.*, sales of gas from the sources designated in the application to the customer designated in the application) for an unlimited period. In short, *Sunray* and *Sun Oil* establish that once the service of supplying gas in interstate commerce has been authorized and has commenced,[17] " 'there can be no withdrawal of that supply from continued interstate movement without Commission approval' "

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thus automatically be free at a future date, untrammeled by Commission regulation, to reassess whether it desired to continue serving the interstate market.

[16] The order granting Gulf's certificate (A. 23-40), which was before this Court in *Sun Oil*, was an omnibus order granting more than 100 identical certificates of public convenience and necessity, the terms of which the Court set out at 364 U.S. at 172, n. 2. Noting that "the certificate issued makes no reference to any limitation of time," the Court stated, "we would hardly see any basis for overturning the Commission's view that no limitation as to time was implied" (364 U.S. at 175).

[17] It is settled that this commitment, once made, is binding on those who later come into possession of the mineral estate. As the court of appeals stated in *Hunt* v. *Federal Power Commission*, 306 F.2d 334, 342 (C.A. 5), "[l]ike the ancient covenant running with the land, the duty to continue to deliver and sell flows with the gas from the moment of the first delivery down to the exhaustion of the reserve, or until the Commission, on appropriate terms, permits cessation of service under § 7(b) * * *" (citations omitted). See also *Mitchell Energy Corp.* v. *Federal Power Commission*, 533 F.2d 258 (C.A. 5).

(*Sunray, supra*, 364 U.S. at 156, quoting from *CATCO, supra*, 360 U.S. at 389). The service must continue until the supply is exhausted or until the Commission authorizes abandonment, even though the supplier may have no contract obligation to deliver the gas and the customer no contract right to receive it, and even though the supplier's application was limited to a finite quantity of gas over time.[18]

Those principles apply fully to this case. It is not disputed that Gulf properly undertook an interstate service in natural gas from its leaseholds, which service was authorized by certificates from the Commission that contained no time limitation. Gulf clearly had the authority under its leases to develop and sell the gas to interstate purchasers.[19] Under the Act

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[18] The Commission may, of course, issue certificates limited to a specific period of time or to finite quantities of gas over time. *Federal Power Commission* v. *Moss*, 424 U.S. 494. But *Sunray* and *Sun Oil* established that unless otherwise limited in the certificate, the service that a certificate authorizes is the supply of gas in the manner proposed in the application or in the contract referred to in the application, and that the service must continue until the source is exhausted or the Commission authorizes abandonment, even though the contract contemplated a finite term and thus the delivery of a finite quantity of gas.

[19] Indeed, as the Commission suggested (A. 713), Gulf had the duty under the leases to do so, since, as this Court recognized in *CATCO, supra*, 360 U.S. at 394, at the time of Gulf's contracts with El Paso and Phillips the interstate market was the principal available market for natural gas.

A gas lease contains an implied covenant to develop and market the gas. *Weymouth* v. *Colorado Interstate Gas Co.*,

as construed in *Sunray* and *Sun Oil*, that service must continue until the Commission permits its cessation, even though Gulf's leases have terminated and the present suppliers are the holders of the reversionary interest in the gas.

For the purposes of the Act, it is immaterial that rights and interests have changed as a result of the expiration of a lease rather than a contract. The rationale and result of *Sunray* and *Sun Oil* would not have been different if the producers had undertaken to supply gas to interstate customers for a fixed term by means of lease arrangements instead of sales contracts.[20] The proposition that the expiration of a lease terminates the obligation to continue certificated service would frustrate the purposes of

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367 F.2d 84 (C.A. 5). See also *Cole Petroleum Co.* v. *United States Gas & Oil Co.*, 41 S.W. 2d 414 (Tex. Sup. Ct.); 5 Williams & Meyers, *Oil and Gas Law*, pp. 388, *et seq.* (1975).

[20] That very situation was presented in *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392. Producers of gas had long-term sales contracts with a pipeline, which contracts, after the *Phillips* decision, came under the Commission's jurisdiction over the "sale" of gas in interstate commerce. Section 1(b), 15 U.S.C. 717(b). The parties then withdrew their sales contracts and substituted an arrangement whereby the pipeline acquired the producers' leasehold interests, the producers (or one of them) continued to operate the production, and the producers were compensated largely on the same basis as before. Although the result of the transaction may not have constituted "sales" of gas under state law, this Court held that the Commission had jurisdiction over the transaction, stating (381 U.S. at 400): "A regulatory statute such as the Natural Gas Act would be hamstrung if it were tied down to technical concepts of local law."

the Act to the same extent and for the same reason as the contentions rejected in *Sunray* and *Sun Oil*. Producers and pipelines would be able to limit their service obligations under the Act, to evade rate regulation, and to disrupt the interstate supply of gas by conducting business through short-term lease arrangements—or through leases terminable at will or on specified conditions, such as rises in intrastate gas prices. In either the lease or the contract situation, the obligation to continue certificated service is not "one imposed by [private agreement] but by the Act." *Sunray*, *supra*, 364 U.S. at 155.[21]

Respondents and the court below have attempted to distinguish *Sunray* and *Sun Oil* on the basis of the Court's observation in *Sunray* that the applicant there was free to "avail itself of its undoubted right to stand firm on its own application, and reject the proffered certificate" (364 U.S. at 141) (and

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[21] Similarly, it makes no difference that the lessors may not have anticipated that the lessee's sales might subject the lessors to an obligation to continue interstate service. In *Sun Oil*, for example, the petitioner did not anticipate when he signed a ten-year sales contract in 1947 that this Court in 1954 would interpret the Act as requiring him to obtain a certificate to sell his gas and that the certificate he obtained would require him to continue that service after the contract term. Moreover, as the courts have recognized in the context of railroad leases (see discussion at pp. 21-27, *infra*), the passage of the Natural Gas Act found the production and sale of natural gas under a variety of lease and contract arrangements and simply added regulatory conditions to the operation and termination of such arrangements. That such conditions may have been unanticipated does not lessen their force and effect. See also note 22, *infra*.

thus, presumably, to decline to sell its gas to interstate purchasers). In contrast, it is asserted, the lessors here were powerless to prevent Gulf, the lessee, from obtaining its certificates and dedicating the gas by its interstate sales. (See Respondents' Br. in Opp., p. 8; Pet. App. 8a-9a.)

The distinction is untenable. First, it is by no means clear that the lessors were powerless to prevent Gulf from dedicating the leasehold gas to interstate commerce or from obtaining a certificate for that purpose. As the Commission noted, the lessors could have intervened in the certification proceeding to assert their interests in the gas or otherwise resist the certificate, but they did not do so. Nor does the record indicate that the lessors made any protest to Gulf, or took any other action to prevent the interstate sale of the leasehold gas. Instead, as the Commission noted, the lessors were apparently satisfied with the sales to El Paso and accepted royalties from those sales.

Second, a person's obligation to continue interstate service under the Natural Gas Act does not depend on his having had an opportunity to decline the certificate authorizing the service or to elect not to sell the dedicated gas in interstate commerce. The Commission has long established that a successor in interest to gas producing fields (*e.g.*, a purchaser of fee interests or a purchaser of leaseholds) is bound by the interstate dedication of his predecessor in interest even though the successor never had an opportunity to decide against the dedication. *Cumberland Natural*

Gas Co., 34 FPC 132; *Blair Vreeland*, 53 FPC 843. So far as the purposes of the Natural Gas Act are concerned, it should be immaterial whether the successor's interest is that of an assignee, a purchaser, or a reversioner under a terminated lease.[22]

B. *Decisions Of This Court Under The Interstate Commerce Act Further Support The Commission's Determination That Respondents May Not Withdraw Their Gas From The Interstate Market Without Commission Approval.*

The holding of the court of appeals is contrary to the long settled construction by this Court and the Interstate Commerce Commission (ICC) of the parallel abandonment provisions of the Interstate Commerce Act. Section 7(b) of the Natural Gas Act follows Section 1(18) of the Interstate Commerce Act, 49 U.S.C. 1(18), which was added to the Interstate

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[22] It is true that a purchaser or assignee (unlike a reversioner) may be said to be on notice of the interstate dedication when he chooses to acquire his interest, but decisions of this Court have made it clear that the purposes of the Natural Gas Act supersede the expectations of private parties, and that the regulatory consequences of the Act do not depend on these expectations. Thus, as noted, the parties in *Sunray* and *Sun Oil* did not expect, when they entered into fixed term sales contracts, that the Natural Gas Act would require the sellers to continue service beyond the terms of the contracts. For the same conclusion with respect to railroads, see pp. 25-26, *infra*.

In addition, the holders of the reversionary interests here are, in substantial part, not the original lessors but persons and companies who acquired their interests after the leases were in effect. See notes 4 and 5, *supra*.

Commerce Act by Section 402 of the Transportation Act of 1920, 41 Stat. 477-478.[23]

Thus in *Smith* v. *Hoboken Railroad Co.*, 328 U.S. 123, the lessor, who had leased railroad property to a railroad in 1906, sought to terminate the lease pursuant to its terms and take over operation of the road. Even though the lessor was willing to assume operations, this Court held that the lessor could not terminate the lease because termination would constitute abandonment of operations by the lessee, and "a certificate [of abandonment from the ICC] is

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[23] 49 U.S.C. 1(18) provides in pertinent part:

> * * * [N]o carried by railroad subject to this chapter shall abandon all or any portion of a line of railroad, or the operation thereof, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity permit of such abandonment. * * *

Respondents' contention (Br. in Opp., pp. 9-10, n. 21) that the abandonment provisions of the two statutes are not parallel is without merit. While respondents assert that there are "[s]ubstantial differences between regulation of railroad service and regulation of interstate sales of natural gas" (*ibid.*), they have not identified any such differences, and we can perceive none that are material to this case. Both statutes are inapplicable to wholly intrastate commerce and both statutes were designed to protect the national interest in continued interstate service at just and reasonable rates. As this Court stated in *Sunray*, *supra*, 364 U.S. at 141-142 and n. 9, these two statutes, Section 1(18) of the Interstate Commerce Act and Section 7(b) of the Natural Gas Act, represent "a common pattern in federal utility regulation in forbidding such abandonment 'without the permission and approval of the Commission first had and obtained.'"

required under § 1(18) whether the lessee or the lessor is abandoning operations." 328 U.S. at 130. Similarly, in *Thompson* v. *Texas Mexican Railway Co.*, 328 U.S. 134, the lessor of certain trackage rights sought to terminate the lessee's use of the tracks pursuant to the terms of the lease (which provided for termination at will on twelve months' notice). This Court held that the lessee's trackage rights could not be terminated without the ICC's permission under Section 1(18). The Court noted that, as was the case in *Smith* v. *Hoboken Railroad Co.*, "the fact that the trackage contract was entered into * * * prior to the passage of [Section 1(18)] is immaterial; the provisions of the Act, including § 1 (18), are applicable to contracts made before as well as after its enactment." 328 U.S. at 144. With particular relevance here, the Court also stated (328 U.S. at 147):

> There would be no difference in result merely because the trackage contract expired by its terms or was terminated by operation of an escape clause. Until abandonment is authorized, operations must continue.[24]

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[24] While the lessees in both *Smith* v. *Hoboken Railroad Co.* and *Thompson* v. *Texas Mexican Railway Co.* were railroads in reorganization under Section 77 of the Bankruptcy Act, 47 Stat. 1474, as amended, 11 U.S.C. 205, the Court gave no indication that that fact limited the general validity of the propositions stated, and there is no reason why it should. Thus the Court's statement that "[w]hether the public interest requires that the line be operated by the lessee rather

Those decisions of this Court relied on and confirmed earlier decisions of the ICC. Thus in *Chicago & Alton Railroad Co.* v. *Toledo, Peoria & Western Railway Co.*, 146 ICC 171 (cited with approval in *Thompson* v. *Texas Mexican Railway Co.*, *supra*, 328 U.S. at 144), the Chicago & Alton Railroad had leased from the Toledo, Peoria & Western Railway (Toledo), before the enactment of Section 1(18), joint use of a certain portion of Toledo's track. The lease was terminable on twelve months' notice, and in 1927 the successor to Toledo gave such notice. The Chicago & Alton then filed a complaint with the ICC alleging that the public interest required continuance of its service. The ICC agreed despite the terms of the lease. First, it ruled that termination of operations under lease was within the abandonment provisions of its statute (146 ICC at 180-181):

> Although there is no express reference in these provisions to the * * * withdrawal of operations under lease, it seems clear that such * * * withdrawal is within the intended scope of the statute. The public interest in transportation lies primarily in the operation of railroads rather than in the facilities themselves. Operation under lease may comprise the entire operation of a line or any portion of such operation, and the public interest therein is obvious, the extent varying with the circumstances. * * * In our opinion we have jurisdiction over the abandon-

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than the lessor presents a question for the Commission under § 1(18) * * *" (328 U.S. at 130) is true whether the lessee is in reorganization or simply a party to an expired lease.

> ment of the "operation" of a railroad under a trackage agreement * * *.

The ICC then addressed the contention that the lessor had a right to terminate the lease under local law (146 ICC at 181):

> It may be contended, however, that the parties have a legal right to rely upon the terms of their contract. Such a contention can not be sustained. The statute, upon its enactment, found railways in operation under various conditions, including, as in this case, operation under lease, by agreement between the owner and the user of facilities. The statute, in effect, added a new condition to the provisions for termination of such arrangements, namely, the condition that no abandonment of the operation in interstate or foreign commerce might occur without our approval.

The ICC recognized the very danger, suggested by this case, of manipulation of Commission jurisdiction by restructuring leases (*ibid.*):

> If our jurisdiction * * * is to be limited or circumscribed by the specific provisions of the contract and is only exercisable during the life of the contract as stated on its face, it could be entirely defeated by short-term contracts made renewable at the option of the parties.

See also *Chicago & North Western Railway Co.* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Co.*, 502 F. 2d 193 (C.A. 7).

In an even more closely analogous case, the ICC refused to allow a lessor to abandon interstate rail

service upon the expiration of his lessee's 50-year fixed-term lease. The Commission reached this conclusion despite the lessor's claim that it was not subject to the Commission's jurisdiction because it had ceased to be an operating railroad prior to the passage of the Interstate Commerce Act in 1887. *Lehigh Valley Railroad Company Proposed Abandonment of Operation*, 202 ICC 659.

The principle of these cases is evident: The enactment by Congress of the Transportation Act of 1920 encumbered all interstate railway operations, including operations undertaken under lease, with the requirement that such service could not be abandoned without ICC authorization. Similarly, the enactment of the Natural Gas Act, as construed in *Phillips*, imposed the requirement that no interstate service in natural gas, including service based on leased reserves, could be terminated without abandonment authorization from the Federal Power Commission under Section 7(b) of the Act.

Respondents contend that the foregoing cases involved lessors who were themselves railroad carriers subject to the ICC's jurisdiction under the Interstate Commerce Act; relying on *Meyers* v. *Famous Realty, Inc.*, 271 F. 2d 811 (C.A. 2), certiorari denied, 362 U.S. 910, they argue that a certificate of abandonment is not required when a lessor who is not a railroad subject to the ICC's jurisdiction comes into possession at the termination of a lease. Respondents' Br. in Opp., p. 10. They argue further that, as simple lessor-landowners, they are not "natural gas

companies" subject to the Natural Gas Act (citing *Mobil Oil Corp.* v. *Federal Power Commission*, 463 F. 2d 256 (C.A. D.C.), certiorari denied, 406 U.S. 976), and that abandonment authority accordingly is not required when they come into their reversionary interests (Br. in Opp., p. 11). Those arguments are erroneous.

First, *Meyers* is inapposite. In that case a lessee railroad, Jay Street, leased railroad properties from a partnership in 1941 and operated them. In 1945 the defendants, Famous Realty, Inc. and its distributees, acquired all the properties of both the lessee and lessor, and thus stood in the shoes of both. In 1959 the ICC granted Jay Street a certificate of abandonment—a fact respondents fail to note—and it was in those circumstances that the court held that Famous Realty, as a lessor, was not required to obtain a certificate to terminate operations.[15] That holding is entirely consistent with the Commission's holding here (A. 611) that Gulf, the lessee, despite the expiration of the lease, would be required to obtain abandonment authorization before abandoning sales from the Crane County acreage. See p. 8 and note 11, *supra*. The principle of the railroad cases, including *Meyers*, is that, once railroad operations are commenced under lease, the service may not be terminated unless some party, either the lessor or the

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[15] *City of New York* v. *United States*, 337 F. Supp. 150 (E.D. N.Y.), also cited by respondents (Br. in Opp., p. 10, n. 24), is inapposite for the same reason; there too the lessee railroad obtained abandonment authority from the ICC.

lessee, obtains abandonment authorization from the regulatory authority.[26]

Second, respondents' apparent contention that a successor in interest to gas producing property who was not formerly a natural gas company within the meaning of Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b), is not within the Commission's jurisdiction and thus does not need permission to cease interstate sales would eviscerate the Natural Gas Act. It would mean that a real estate developer succeeding in interest (by purchase, inheritance, or any other means) to gas fields vital to the nation's interest could, without Commission approval, shut down production and build a shopping center. Applied to the Interstate Commerce Act the proposition would be equally devastating.[27]

Finally, respondents' reliance on *Mobil Oil Corp., supra,* is unfounded. There the court held only that

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[26] Moreover, respondents' contention that the railroad cases impose a service obligation only on lessors who were carriers subject to ICC jurisdiction ignores the *Lehigh Valley Railroad* case, *supra,* in which, as noted at p. 26, *supra,* the lessor was required to operate the road notwithstanding its claim that it had ceased to be a carrier before the enactment of the Interstate Commerce Act.

[27] In any event, respondents' attempt to depict themselves as landowners who "merely lease[d] [their] properties to a 'natural gas company'" (Br. in Opp., p. 11) and who are thus presumably incapable of assuming their lessee's interstate operations is unpersuasive on the facts of this case. Respondents (Southland, Exxon, Texaco *et al.*) fully intend to continue selling their gas; they merely want to sell it on the intrastate market. See also note 22, *supra.*

lessors, having solely royalty interests in their lessees' operations, were not natural gas companies within the Commission's jurisdiction, at least for purposes of regulating the royalty agreements. The court did not consider whether, on termination of the leases, such former lessors who succeed to the interest of their natural gas company lessees would be natural gas companies within the meaning of the Act, or whether they could terminate interstate sales. *Mobil Oil Corp.* does not apply to *former* lessors like respondents, and there is no reason under the Natural Gas Act to treat a party who succeeds to the interests of a natural gas company by reversion differently from a party who succeeds to such interests by any other means.

C. *The Decision Of The Court Of Appeals Would Severely Impair The Commission's Regulatory Authority.*

The decision of the court below, in permitting lessors to terminate interstate services in natural gas without Commission authorization, would seriously undercut the Commission's ability to assure an adequate and reliable supply of natural gas to the nation. Immediately, the decision would free billions of cubic feet of natural gas reserves from their interstate dedication. Gulf has been selling interstate to El Paso approximately 25 million cubic feet per day of gas attributable to the Waddell Lease (A. 403) and 18 million cubic feet per day of gas attributable to the Goldsmith Lease (A. 409). In addition, continued dedication of the reserves under-

lying numerous other fixed-term leases that expired in 1976 depends on the result of this case.[18]

Further, it makes little difference that the leases in question here were fixed-term leases while many leases today are life-of-the-well leases. While respondents have argued that fixed-term leases of the kind involved here are no longer common (Br. in Opp., p. 11), the rationale of the court below would apply to leases that are terminated for any reason pursuant to their terms. The decision thus creates a substantial incentive for lessors and producers to draft their leases in ways permitting termination when market conditions make it advantageous.[19]

Indeed, the court below has recently interpreted its decision in this case as applying to life-of-the-well leases terminable on certain conditions. *Pennzoil Pro-*

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[18] The following cases are pending in the Fifth Circuit awaiting the outcome of this case: *Dore Corp. and Sullivan-Wells Co.* v. *Federal Power Commission*, No. 76-2428, *Ft. Worth National Bank, et al.* v. *Federal Power Commission*, No. 76-2808, *Briercrest Oil Co.* v. *Federal Power Commission*, No. 76-2828 (appeals of FPC orders dated March 12, 1976, March 24, 1976, and May 7, 1976); *Dore Corp. and Sullivan-Wells Co.* v. *Federal Power Commission*, No. 76-4093, *Briercrest Oil Co.* v. *Federal Power Commission*, No. 76-4169 (appeals of FPC orders dated September 8, 1976, and October 27, 1976); and *Ft. Worth National Bank, et al.* v. *Federal Power Commission*, No. 76-3785 (appeal of FPC orders dated July 6, 1976, and September 3, 1976).

[19] While respondents have argued that it would not be in a lessee/producer's economic interest to enter into short-term leases (Br. in Opp., p. 13), it would not be difficult to devise lease arrangements that maximized both parties' options to leave the interstate market when this served their mutual advantage.

ducing Company v. *Federal Power Commission*, 553 F. 2d 485 (C.A. 5), rehearing denied, September 1, 1977 (see note 31, *infra*). In that case Pennzoil and Shell, producers selling gas in interstate commerce under life-of-the-well leases, sought special relief from Commission ceiling rates in order to pay to their lessor royalties which, by the terms of the leases, were to be based on the intrastate "market value" of the leasehold gas. The leases contained standard provisions for termination in the event royalties were not paid as required. When the producers cited the threat of cancelled leases and consequent diversion of gas from the interstate market, the Commission replied that "[i]f the leases were cancelled and [the lessor] were to undertake to sell the subject gas, [the lessor] would simply assume the obligations of Pennzoil and Shell to continue service to [the interstate pipeline]." [30] The Commission then rejected the lessees' request to raise their interstate rates because of their higher royalty payments and also their alternative request to pay the lessor royalties in kind, that is, in gas which the lessor could sell on the intrastate market. The court, reversing the Commission, said (553 F. 2d at 489):

> Thus the Commission was under the impression that [the lessor's] gas was trapped in the interstate market, whether or not the leases were terminated.

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[30] Opinion No. 753, *Pennzoil Producing Co., et al.*, issued January 30, 1976, p. 9.

Citing its decision in the instant case, the court declared that "the Commission was acting under the wrong legal premise" (*ibid.*), and remanded to the Commission "for reconsideration in light of *Southland Royalty*" (*ibid.*).[31]

The court of appeals in *Pennzoil* thus appears to have construed its decision in this case in a way that would permit any gas sold in interstate commerce pursuant to Commission certificates to be withdrawn from that service without Commission approval on the

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[31] The court also concluded that since in its view cancellation of the leases would permit the lessor to withdraw the entire supply from the interstate market,

> [i]t may well be that the "present or future public convenience or necessity" will suggest [to the Commission] the propriety of abandoning a fraction of the gas in [the lessor's] property [by allowing the lessees to pay royalties in kind], rather than lose the entire amount from the interstate market. [553 F. 2d at 489.]

The Commission petitioned for rehearing for the limited purpose of requesting the court to delete all reference to the instant case and to the lessor's supposed right to withdraw gas from the interstate market upon termination of the leases, since there were alternative grounds for the decision and since the instant case is currently pending this Court's review. The court recently granted the petition in part by deleting the language set forth in this note, on the ground that it was premature to indicate what the Commission might conclude on remand. *Per curiam* opinion denying petition for rehearing, September 1, 1977, attached hereto as Appendix B, *infra*, pp. 4a-5a. But the modified opinion continues to make clear that in the court's view the lessor is free to withdraw the gas when and if he terminates the lease.

occurrence of an event that terminates the lease.[32] *Pennzoil* casts in bold relief the court's fundamental error here of confining certificated public service obligations by the terms of private leases. The court was wrong in rejecting the Commission's basic premise that once gas flows in interstate commerce pursuant to a properly obtained Commission certificate, there may be no termination of service until the dedicated reserves are exhausted or the Commission authorizes abandonment. As *Pennzoil* indicates, the effect of the decision below is potentially very broad. Unless that decision is overturned, the concept of dedication of service, which this Court has recognized and defined in past cases and which is essential to the purposes of the Natural Gas Act, will be undermined.

D. *The Decision Of The Commission In This Case Is Not Inequitable With Respect To The Reversioners.*

Contrary to the apparent view of the court of appeals, there is nothing inequitable about the Commission's position, and certainly not on the facts of this case. As we have noted, Gulf, as lessee of a mineral

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[32] In another case now pending in the Fifth Circuit, gas from several leases had been dedicated to interstate service and gas from some of the leases had begun to flow in interstate commerce but the other leases had been allowed to lapse. Citing the court's decision in this case, the lessors and subsequent lessees of the acreage have claimed that the dedication of the reserves under the lapsed leases automatically terminated. *Northern Natural Gas Co.* v. *John L. Crawford*, Docket No. CS71-6 (issued September 29, 1976), appeal docketed *sub nom. Harrison* v. *Federal Power Commission*, C.A. 5, No. 76-4318, December 19, 1976.

interest, had an implied obligation to its lessors to develop and market the gas underlying the leaseholds in order to permit the lessors to earn their royalties (see note 19, *supra*, and accompanying text). In the early 1950's the interstate market was the principal market for such large quantities of gas (*CATCO*, *supra*, 360 U.S. at 394). Gulf entered the interstate market in fulfillment of its lease obligations and for the benefit of its lessors. As the Commission noted (A. 713, n. 3), "the lease owners apparently had no objection to interstate dedication, for they accepted royalties from such sales." [33] Having authorized and benefited from their lessee's interstate sales of leasehold gas, the reversionary mineral owners have no equitable basis for claiming that they should not be bound by the regulatory consequences of those sales.

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[33] It is not unreasonable or inappropriate to assume that the reversionary mineral owners, had they been in possession at the time, would have made the same interstate sales. See also note 22, *supra*.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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SEPTEMBER 1977.

APPENDIX A

The Natural Gas Act, 52 Stat. 821-833, as amended, 15 U.S.C. 717-717w, provides in pertinent part:

Section 1(b):

The provisions of this Act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas. [15 U.S.C. 717(b)]

Section 7(b):

No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment. [15 U.S.C. 717f(b)]

Section 7(c):

No natural-gas company or person which will be a natural-gas company upon completion of

any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: *Provided, however,* That if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on February 7, 1942, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after February 7, 1942. Pending the determination of any such application, the continuance of such operation shall be lawful.

In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: *Provided, however,* That the Commission may

issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest. [15 U.S.C. 717f(c)]

Section 7(e):

Except in the cases governed by the provisos contained in subsection (c) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of the Act and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require. [15 U.S.C. 717f(e)]

APPENDIX B

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

Nos. 76-1626, 76-1831, 76-2128

PENNZOIL PRODUCING COMPANY, ET AL., PETITIONERS

v.

FEDERAL POWER COMMISSION, RESPONDENT

Sept. 1, 1977

Petitions for Review of an Order of
Federal Power Commission

(Texas Cases)

ON PETITION FOR REHEARING

(Opinion June 6, 1977, 5 Cir., 1977, 553 F.2d 485)

Before CLARK, RONEY and TJOFLAT, Circuit Judges.

PER CURIAM:

In its petition for rehearing, the Federal Power Commission asserts that language in the opinion may erroneously indicate the prejudgment of an issue not before the Court, *i.e.*, the effect of our decision in *Southland Royalty Co.* v. *FPC*, 543 F.2d 1134 (5th Cir. 1976) on a state court termination of a lease, particularly one not limited by a fixed-term.

In order to pull from the opinion any indication as to how *Southland* might apply to the facts of this

case, we delete from our opinion the last two sentences found at the end of the final paragraph, which read as follows:

> It may well be that the "present or future public convenience or necessity" will suggest the propriety of abandoning a fraction of the gas in Williams' property, rather than lose the entire amount from the interstate market. This decision is for the Commission.

We agree with the Commission that the statement was premature, if construed to be decisional, and unnecessary with respect to our decision.

IT IS ORDERED that the petition for rehearing filed in the above entitled and numbered cause be and the same is hereby DENIED.

☆ U. S. GOVERNMENT PRINTING OFFICE, 1977 245883 60

No. 76-1587

In the Supreme Court of the United States

October Term, 1977

Federal Energy Regulatory Commission, petitioner

v.

Southland Royalty Company, et al.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

Wade H. McCree, Jr.,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 76-1587

FEDERAL ENERGY REGULATORY COMMISSION, PETITIONER

v.

SOUTHLAND ROYALTY COMPANY, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION*

The State of Texas in its brief *amicus curiae* contends, and the States of Louisiana and New Mexico in their *amicus* briefs agree, that the position taken by the Commission in this case would "create a new and

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*Pursuant to the provisions of the Department of Energy Organization Act, Pub. L. 95-91, 91 Stat. 565 (August 4, 1977), and Executive Order No. 12009, 42 Fed. Reg. 46267 (September 13, 1977), the Federal Power Commission ceased to exist on September 30, 1977 and most of its functions and regulatory responsibilities were transferred to the Federal Energy Regulatory Commission, which, along with the Department of Energy, was activated on October 1, 1977. Section 705(e) of the Organization Act, 91 Stat. 607, provides for the substitution of the new Commission as a party in cases such as this. The term "the Commission" as used in this brief refers to either the Federal Power Commission or the Federal Energy Regulatory Commission, as appropriate.

disruptive title risk" (Texas brief 9) for prospective oil and gas lessees. As Texas sets forth the asserted problem, "The Commission held in the orders under review that a lessee can dedicate to an interstate sale all gas ever produced from the acreage he leases" (*id.* at 6). Since "[e]very acre of Texas land has probably been leased many times under now-expired leases," it follows from "the Commission's theory" that "any one or more of the prior lessees may have 'dedicated' the acreage to an interstate sale" (*ibid.*). Therefore: "A producer who holds a current lease on the acreage or is considering acquiring such a lease cannot determine whether unknown gas reserves that may underlie it have been dedicated to interstate sale. This uncertainty will deter onshore exploration of previously leased acreage." *Ibid.;* see *id.* at 7-16.

The fears expressed by Texas are based on a misunderstanding of the Commission's position in this case. The hypothetical situation that Texas poses and the title risks it would allegedly involve are far removed from both the facts and the Commission's position here.

Texas professes concern about a person who has acquired, or who might acquire, a mineral leasehold without knowledge that at some time in the past a prior lessee had dedicated gas reserves underlying that acreage to interstate service pursuant to a Commission certificate and had then abandoned production without obtaining abandonment authority from the Commission.[1] This case is quite different. It involves a continuous flow of natural

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[1] If the prior lessee obtained abandonment authority from the Commission, current or prospective lessees would have no problem, being free to sell gas produced from the lease on the intrastate market or, upon obtaining a certificate from the Commission, on the interstate market.

gas which was being produced by Gulf and sold to El Paso pursuant to certificates of unlimited duration granted by the Commission, and which Southland and the other reversionary mineral interest owners (Southland *et al.*) now assert the right to divert from interstate service by virtue of the expiration of the leases under which Gulf was operating.

The Commission's position in this case is based on the continuing nature of this flow, and on the attempt of respondents to cut it off without the Commission's authorization. Section 7(b) of the Natural Gas Act, 52 Stat. 824 (15 U.S.C. 717f(b)), provides that "[n]o natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained * * *." Given the plain language of this section, the Commission takes the position that the certificated service being rendered by Gulf to El Paso may not be abandoned, either by Gulf or by Southland *et al.*, without the approval of the Commission as required by the Act. The Commission stands on this Court's holding in the *Sunray* case that once the service of supplying gas in interstate commerce has been authorized and has commenced, "there can be no withdrawal of that supply from continued interstate movement without Commission approval." *Sunray Mid-Continent Oil Co.* v. *Federal Power Commission*, 364 U.S. 137, 156, quoting *Atlantic Refining Co.* v. *Public Service Commission of New York (CATCO)*, 360 U.S. 378, 389.

Thus, what the Commission "held in this case" is not, as Texas asserts (brief 10; see also Southland brief 6), that by selling gas from "Blackacre" pursuant to a Commission certificate, a lessee "has dedicated to interstate service reserves that he himself never discovers," or has dedicated

"reserves that might be discovered on Blackacre by another producer, under a different lease, years after his own lease has terminated for failure of production or failure to develop" (Texas brief 10).[2] Indeed, the fear expressed by Texas could hardly be more remote from the facts of this case, where the sales and service conducted pursuant to the Commission's certificate were continuing, notorious, and enormous at the time the leases expired, and where they were peculiarly well known to Southland *et al.*, who had been receiving royalties from them.

In sum, there was no occasion in this case for the Commission to address the hypothetical situation posed by Texas, and it did not do so.

Nor is it true, as Texas asserts (brief 3, 12-13), that the Commission in other cases has embraced the position which Texas ascribes to it and finds so troubling here.[3] Texas relies on two cases now pending in the courts of appeals: *Wessely Energy Corp.* v. *Arkansas-Louisiana*

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[2]Texas describes the theory it attributes to the Commission as one based on a "covenant running with the land" (Texas brief 9-12). The Commission did use that phrase (A. 606), as we did in our opening brief (Brief for the Federal Power Commission, 16 n. 17), but in both cases the reference was to the language of the court of appeals in *Hunt* v. *Federal Power Commission*, 306 F. 2d 334, 342 (C.A. 5), reading as follows: "Like the ancient covenant running with the land, the duty *to continue* to deliver and sell flows with the gas from the moment of the first delivery *down to the exhaustion of the reserve*, or until the Commission, on appropriate terms, permits cessation of service under §7(b) * * *" (emphasis added).

[3]Of course, when a lessee has made certificated sales of gas from the leased acreage and has then assigned the lease, the absence of continuing production does not prevent the conclusion that reserves later discovered on the leased acreage by the assignee or another successor-in-interest have been dedicated to interstate service. See, *e.g.*, *Cumberland Natural Gas Co.*, 34 F.P.C. 132, 138; *Mitchell Energy Corp.* v. *Federal Power Commission*, 533 F. 2d 258 (C.A. 5). Texas concedes (brief 9) that this doctrine "causes no difficulties * * *."

Gas Co. and the Federal Power Commission, W.D. Okla., No. CIV-77-0159-B, issued July 29, 1977, appeal pending, C.A. 10, No. 77-1750; and *Northern Natural Gas Co.* v. *Crawford*, Federal Power Commission Docket No. CS71-6, orders issued September 29, 1976, and December 1, 1976, appeal pending *sub nom. Harrison* v. *Federal Power Commission*, C.A. 5, No. 76-4318 (see Texas brief 3, 12-13). In neither case is the Commission taking the position that Texas ascribes to it.

The *Wessely* case (see pp. 12-13 of the Texas brief) is an action brought in federal district court to quiet title to an oil and gas leasehold estate against claims that natural gas produced from the leasehold was dedicated to sale to an interstate pipeline under the Natural Gas Act. The district court decided that a subsequent lessee is not bound by the interstate dedication made by a prior lessee whose lease had expired without production, and the Commission is presently appealing to the Court of Appeals for the Tenth Circuit. However, the Commission has taken no position on the merits of the question decided by the district court. Its brief in the court of appeals, dated October 13, 1977, argues only that the district court erred in ruling that the Commission lacked primary jurisdiction over the subject matter of the proceeding and in failing to require the appellee, Wessely Energy Corporation, to exhaust its administrative remedies before resort to the courts. As the brief states (at 18): "This is not to suggest that the decision on the merits by the court below is necessarily erroneous, but simply that Wessely's arguments should have been directed to the Commission in the first instance."[4]

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[4]The district court in one paragraph of its opinion (par. 13) did attribute a position on the merits to "the FPC." That would only have meant the Commission's counsel, and any such position has been withdrawn on appeal, where the Commission's brief states (at 18

In the *Harrison* case (see the Texas brief 13, and the Commission's principal brief 33 n. 32), a producer named Crawford had acquired life-of-the-reserves mineral leaseholds in six sections of a Texas county. Shortly thereafter he discovered gas and completed a producing well on one section, made a contract by which he committed all gas production from all six sections to an interstate pipeline (Northern), obtained a permanent certificate from the Commission authorizing the service contemplated by the contract, and began selling gas to Northern from wells on two of the sections. Ten years later, with sales from at least one of those sections continuing, he released his interest in the other four sections back to the lessor. Three days later, Harrison *et al.* took a new lease on those four sections, and within two months had discovered gas and completed a well. The Commission held that Crawford's certificate encompassed all six sections covered by his lease and contract, that the deliveries from two sections served to dedicate to Northern all gas from all six sections, and hence that gas could not be sold intrastate from any of the six sections—including the gas discovered by Harrison *et al.*—without first obtaining abandonment authority under Section 7(b).

Harrison is distinguishable from the hypothetical problem posed by Texas. If Crawford's dedication covered all six sections, as the Commission held, then production from the dedicated acreage was continuing at

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n. 9): "This brief includes no arguments on the merits. Counsel for the Commission are not free to substitute their judgment on the dedication issue for that of the Commission, and an argument either way by counsel would require speculation as to what the Commission would decide. * * *." (A copy of the district court's order, judgment and opinion, dated July 29, 1977, and a copy of the Commission's brief on appeal are being lodged with the Clerk of this Court.)

the time Crawford gave up his interest in four of the six sections. In this respect *Harrison* resembles the instant case, though here it is the continuing production itself whose abandonment is at issue. Because of the continuing production in *Harrison*, the new lessees could not very credibly claim to be without notice of the ongoing interstate service, and they might have a claim against their lessor if they were.

Thus, neither of the cases noted by Texas bears out the fears expressed. In any event, both cases are still awaiting decision in the courts of appeals, leaving ample opportunity for those courts or this Court to avoid any undesirable results. The instant case, meanwhile, presents the sharply focused question whether an ongoing flow of interstate sales and service in natural gas, certificated by the Commission without limit of time, may be cut off and diverted to the intrastate market without the Commission's abandonment approval under Section 7(b). The Commission submits that it may not.

Respectfully submitted.

WADE H. McCREE, JR.
Solicitor General.

DECEMBER 1977.

DOJ-1977-12